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PREFACE

FOLLOWING the procedure started last year and, in fact, going beyond it, this new volume of PUBLIC POLICY is predominately devoted to the problems of economic and political development. It therefore to a very sustaining extent issues from the work done in that seminar by Professors Galbraith, Mason, David Bell and Gustav Papanek. The editors are greatly indebted to Dr. David Bell who gave freely of his time in developing the present volume.

The tenth volume will presumably be focused on work in Public Administration. Professors John M. Gaus, Merle Fainsod and Arthur Maass, among others, are engaged in preparing studies for this volume.

In conclusion it is my pleasant duty to acknowledge the very helpful assistance I have had from the Secretary of the School, Professor Arthur A. Maass, as well as from our editorial assistant, Miss Roberta G. Hill.

CARL J. FRIEDRICH
for the editors

PART I

GENERAL PROBLEMS OF POLITICS AND ADMINISTRATION

CREATIVITY IN THE PUBLIC SERVICE

Don K. Price

A GENERATION or so ago a great many people assumed that the main thing which civil servants needed to learn was simple business efficiency. It was this popular assumption, I think, that did more to fix in the public mind—more than all the writings of Wilson and Goodnow and the other early fathers—the image of public administration as a subject concerned primarily with efficiency and economy, and divorced from any concern not only with politics as partisan competition, but also from politics as the larger purposes of the state.

Nobody thought then that business had anything to learn from government. But today some very authoritative observers are saying that business has been learning a great deal, most of it bad. For example, at the recent 50th anniversary conference of the Harvard Graduate School of Business Administration, Arnold J. Toynbee remarked that today "business and government service seem to be becoming less and less unlike each other."[1] He noted that our current tendencies in business administration were a parallel to what happened in the Roman Empire under Augustus—the establishment of administrative reforms by turning business men into salaried civil servants. This brought about a measure of order and security, but "the price of the orderliness and justice was uncreativeness and dullness."

In this view Mr. Toynbee was expressing an opinion concurring with many of the philosophical and sociological critics of our society today. The organization man is coming in for an awful beating. The philosophers of business management discovered that management was mainly human relations and developed that into a technique, and now some of them are rebelling against the stifling effect of such a technique on the essential purposes of business and society. They are of course not the first to express this point of view. In the fields of public administration and political science, our colleagues began to worry about an overemphasis on efficiency long before most laymen suspected gov-

[1] Arnold J. Toynbee, "Thinking Ahead: Will Businessmen Be Civil Servants" 36 *Harvard Business Review* 5, September-October 1958, p. 23ff. (p. 26.)
[2] *Ibid.*, p. 38.

ernment service of becoming efficient, and to decry the separation of administration from politics well before any major symptoms of that malady could be detected in the average city hall or federal bureau.

It has been this pervasive fear of a monolithic bureaucracy that has led many a student to shy away in recent years from the reforms that were the gospel of the scholar in government a generation ago: the strengthening of the powers and administrative machinery of chief executives, from city managers up to the President, and the development of a corps of generalists to coordinate the business of government.

This change of feeling greatly weakened the desire to train general administrators for the public service. While some objected on principle to the development in America of a career elite corps on the British or European model, others were content to believe that this was not immoral, but only impossible.

Most of these points of view, however, assumed the model (although few of the debaters would have used that word) of government to be a single machine whose administration (aside from its scientific and technical content) was mainly a matter of management in the narrower sense of that word.

This view of the civil service, it may be noted, is simply the seamy side of the broader political argument about the functions of the state—the argument about socialism *vs.* free enterprise. That argument, too, usually assumes that government ownership involves operation as a part of a single large machine; that private business is a separate world in its policies, programs, finance and personnel; and that what is added as a responsibility of government is taken away from the functions of private business.

But in the light of what has actually been going on in government these debates seem to me to miss the main point. There is no question that large organizations are subject to the stifling effects of red tape and conformity, and it is important for business as well as government to be on its guard against these tendencies. There is no question too, that, under the pressures generated by science and technology our society is far more interdependent than ever before and this interdependence is reflected in the growth of governmental budgets and governmental policies. But to go on from there and assume that this

growth involves a simple expansion of a monolithic bureaucracy, at the expense of independent institutions and the qualities of enterprise and initiative that they can foster, is to overlook some of the main facts in contemporary American government.

This point is of some importance. If it makes any sense it has profound implications not only for the type of government organization which we should seek to create, but also for the type of training which ought to be given people who aspire to top positions in the public service. For if we understand correctly what has been happening in American government we shall find, I am convinced, that the old debate between those who are interested in training for management functions and those who are interested in training in policy issues is becoming less and less pertinent to our present problems. If this is so we need to make a new approach at a higher level.

To make clear what I mean let me begin by looking briefly at the way in which the administration of public policy is a business much broader than the management of the Federal bureaucracy alone.

We started with a federal government that undertook to rely largely on its own employees to accomplish its purposes. The Post Office was the biggest single operation and it remains today the department that is the most nearly self-contained in its operations. Most of the others have made some more or less deliberate effort to rely for the operation of their programs on the organized cooperation of agencies that are at least partially independent in their administration.

Obviously the first big movement of this kind was the development of a kind of cooperative federalism. The agricultural programs were too scattered to be handled by a central bureaucracy; hence the land-grant colleges and all of the subsequent state-administered programs supported by grants of money as well as land and involving cooperative federal-state relations. In the twentieth century the need for inter-state highways did not lead to more direct federal construction, as in the Cumberland Road, but to the grant-in-aid system through the state highway departments. Public health and social security, riding on a wave of political and financial centralization, were administratively decentralized.

In other programs the states were unsuitable as agents of national programs, sometimes because their purposes were not acceptable equally to the state legislatures or applicable equally to all areas, or because the function could not be handled geographically within a state's boundaries. This led to the creation of such special purpose districts as those in the local public housing or soil conservation fields, and the creation of special government corporations.

The government corporation disappointed the hopes of its early advocates. It had been intended to establish operating units to be financed and managed separately, to provide within government the flexibility and initiative that are expected of private enterprise, with freedom from the red tape of bureaucratic controls. The label "corporation" was not an adequate shield, however, and bit by bit the agencies of administrative and legislative control reasserted their authority. But the key idea was useful enough to come up again in two ways. The first and more limited one was that of deliberately creating financial or administrative entities within a larger organization, in order to fix responsibility and stimulate initiative more effectively. This was the course followed by the Department of Defense in setting up such services as air and sea transport as if they were financially independent agencies, so that the operating segments of the Department would have an incentive to ration their use of such services just as if they bought them from private agencies. Similarly the General Services Administration began to provide office supplies to other departments through a "super-market" in Washington, to establish similar incentives and reduce the red tape of the governmental supply system.

But the basic idea of the government corporation was applied with more spectacular success by a more fundamental breach with tradition. This was the discovery that governmental functions could be carried on by contract with private institutions. Services as well as goods could be purchased. And so, much as in the system of cooperative federalism with the states, a whole new system began to develop in cooperation with private corporations, offsetting by administrative decentralization the main centralizing drift of contemporary society.

This system began with little fanfare. It had been foreseen in

various theoretical writings, and nobody paid much attention to the first steps in its direction. For example, when the Federal government in the nineteenth century had found it necessary to inspect steamboats, it had established the Federal Steamboat Inspection Service, which is now a part of the U. S. Coast Guard, organized on military lines. By contrast, in the twentieth century, it licensed private firms to perform similar inspections of airplanes.

But it was during World War II that the new idea spread most rapidly. It was a quite pragmatic way for getting on with a public job without raising the issue of public ownership. The railroads had been nationalized, amid great debate, during World War I. They were more effectively directed for government purposes during World War II without government ownership, and so in different ways were many other major industries. Most of these measures were temporary, but other wartime improvisations had more lasting effects, especially in fields of continuing military and scientific importance.

For example, the Office of Scientific Research and Development operated no laboratories directly, but carried on its work by contracts with a wide range of universities and industries. So in part did the Army Air Forces, and the Air Force, when set up separately after the war, followed the same practice to avoid the difficulty and loss of time that would have been required by the building of new facilities to parallel the Army arsenals or Navy laboratories. Similarly, the Atomic Energy Commission continued the contractual arrangements of the Manhattan Engineer District of World War II. And most recently the race for outer space has led to the transformation of the National Advisory Committee for Aeronautics, mainly a direct government operation, into the National Aeronautics and Space Agency, which expects to handle its expanded affairs largely through contracts.

This system reaches its ultimate development—so far—in the creation of special private corporations designed primarily to carry on governmental functions. And it is significant that some of these are in fields of activity which traditionally have been considered exclusively governmental in nature. The study of basic weapons and weapons systems and their relation to tactics and

strategy have hitherto been considered in the United States—as they still are elsewhere—as functions at the core of military planning, the one function which not even the most ardent apostle of private enterprise would claim as outside the scope of government. But it was for this purpose that the Rand Corporation was set up to serve the Air Force, and the Institute of Defense Analyses for the Department of Defense.

The significance of these developments for public administration—for those who engage in it as a profession and for those who seek to train others for its practice—goes far beyond the fields in which this "federalism by contract" has already appeared. This approach has gone furthest in areas where there has been no important border warfare between business and government. Nobody knows yet whether it is a device for keeping government out of business and supporting private enterprise in preference to bureaucracy, or alternatively whether it is a means of extending government control over business operations. It can be either. And it will probably be some of both. How it will all turn out in the future is anybody's guess. But two or three things seem clear.

First, here is a way of accomplishing a government purpose with more operating flexibility than in any device hitherto invented. Grant-in-aid programs through the states require reasonably uniform coverage everywhere and the programs still have to be administered by state government agencies, which are likely to be even more cramped by red tape than their federal counterparts. To work through a private corporation imposes no restrictions of geography; here you escape much of the business of allocating funds in proportion to population or in response to regional and local pressures.

By comparison with the government corporation, the contract with a private corporation has an equally important and even more simple advantage: the Congress will respect the relative autonomy of a private corporation. The contracting agency, in theory, can use the contractual device to control every detail of the private corporation's operations—the salaries it pays, the people it appoints, and so on. But the executives and employees are not technically government employees. This distinction is of great symbolic importance, as anyone can tell by looking at the

degree of detail in which appropriation sub-committees look at funds budgeted for direct expenditure by Federal agencies, by comparison with those budgeted for expenditure through contract with what are technically private corporations. I do not want to seem to suggest that here is a way in which Congress has been bamboozled. Quite the contrary. Congressmen, like administrators, generally play the game according to the rules as they understand them and Congressmen, like administrators, have been relieved to find a device which lets great segments of urgent and complex business get done by a method of delegation that is politically respectable.

The best indication that Congress fully understands what it is doing is the fact that in 1958 it looked over this total system, in the fields pertaining to basic scientific research, and made it even more flexible by permitting all agencies with authority to make contracts to do the same thing through grants of funds.[3] The main difference of course is that the grant requires a less detailed proof of specific services rendered, and gives much greater freedom from red tape with respect to accountability in all its procedural forms.

What are the limitations on this way of doing public business? I see very few, in any absolute sense, or with respect to broad fields of activity. Foreign affairs? We are already over that hurdle; the International Cooperation Administration contracts with all sorts of institutions to carry on programs abroad that are indistinguishable from those of the cultural affairs program of the State Department itself, or the international programs of such departments as Agriculture. And the Science Advisory Committee in the Executive Office of the President contracted with a private corporation to provide the staff work for the fundamental review of our international security position that was popularly known as the Gaither Committee.

The Post Office? There was a great deal of talk about turning its function over to a private corporation during the time of the second Hoover Commission. The idea got nowhere, perhaps because it looked like turning the clock back. But some day the postal unions may look on it as a way to turn the clock forward; as employees of a private corporation they would be even freer

[3] Public Law 85-934, 85th Congress, S. 4039. September 6, 1958.

to lobby for higher salaries than they are now—perhaps even to strike. A private corporation carrying the mails might well turn out to raise the costs of the operation rather than lower them. If those engaged in the work should ever get that idea, they might be tempted to make the Post Office a "private enterprise."

But to say there are no limits on this movement is not to say that no limits are desirable. Our debates about private *vs.* public operation of various functions has been sterile because it has been conducted mainly in terms of government ownership, long after economists have learned that the ownership of the modern private corporation is a very slippery concept.

If the question is seen in realistic terms we shall have to devise some way of calculating whether a particular function can be performed best in the public interest as a completely governmental operation at the one extreme, or a completely private operation at the other extreme, or by some mixture of the many infinitely varied possibilities of elements of ownership, regulation and management that our precedents suggest.

If the problem is seen from this point of view, it becomes a little less clear that all government administrators ought to be held down to the rigid system of salary scales and personnel tenure provided by the Classification Act. If the purpose of a specific contractual arrangement is merely to provide more efficient management in the dollars-and-cents meaning of internal efficiency, we may soon have to face the question whether the government would not do well to build the necessary flexibility into its own structure. If a job can be done cheaper by paying better executive salaries and providing less red tape—two of the most obvious characteristics of operations under private contract—maybe the government agencies themselves should pay better executive salaries and require less red tape. Then perhaps we could do without one of the two layers of administrative or executive personnel—one layer being those who administer the work in the private corporation, the other those in the bureau who pass on the basic plans and let the contract.

The answer to this question will depend on a good many considerations that have not been analyzed in any systematic way, but the question is already being asked, and not merely as an academic exercise. In the hearings that led to the creation of the new

National Aeronautics and Space Agency, Chairman Ellsworth of the U. S. Civil Service Commission was pressed by his questioners on the issues involved in the proposal to pay a substantial number of N.A.S.A. executives as well as scientists salaries at rates competitive with those in private corporations. The case for this proposal—which amounted to proposing that top scientists and executives be paid at prevailing private rates, a formula hitherto applied only to "blue collar" workers—was especially strong since most of the private corporations competing with the N.A.S.A. for personnel were paying their people out of funds drawn from government contracts. But Congressmen naturally wanted to know where they could stop, once the basic principle was adopted. And Chairman Ellsworth went on to say that perhaps the same principle would have to apply ultimately to executive as well as scientific personnel throughout the government.[4] May what is good for organized labor and good for nuclear physicists ultimately be good for government administrators? The notion is revolutionary.

But the best case for the contractual system is not the argument of simple internal efficiency. If that were all, it should be looked on as a mere subterfuge to escape the handicaps of governmental regulations, and the best course of action would be to reform the system of governmental management. But the case is a more fundamental and compelling one. It is substantially the same reason which has led Standard Oil of New Jersey or General Motors to operate through corporate subsidiaries rather than through a massive centralized bureaucracy. Only by a measure of detachment from the processes of operational management can top administration best direct its attention and energies to its essential problems—the determination of objectives, the scheduling of its program, the coordination of the various elements of that program, and the continuous evaluation of progress toward the main purposes of the organization.

In a business corporation, this degree of detachment may be attained within a single organization, even though some of the biggest ones have decided otherwise and set up corporate sub-

[4] U.S. Congress. House Select Committee on Astronautics. *Astronautics and Space Exploration.* Hearings 85th Congress, 2d Session, on HR 11881. Washington, U.S. Government Printing Office, 1958. pp. 1385-1386.

sidiaries. But in a political setting, all the pressures work against this degree of detachment. Politicians and journalists are not as persuaded of the virtues of delegation as are corporate executives. And their desire to pin on the President and his administration responsibility for all the details of governmental operation, or to control them through the procedures of Congressional committees, tends to make impossible the attainment of administrative flexibility through internal delegation.

And delegation is desirable for political as well as administrative reasons. It has become conventional to admit that policy and administration are closely related, and that the administrator must be concerned with policy. But the interrelationship is more profound and fundamental than can be described in terms of the interests and activities of any individual. It may best be illustrated perhaps by looking at the contrast between two fields—that of agriculture, the first in which government came to play a major continuous positive role in the economy, and that of national defense, in which the extent and patterns of intervention in the economy have mushroomed so rapidly that they are much less clearly understood.

In agriculture, we have always assumed that the President and the Congress had a free hand in selecting the principal issues, appraising them, and acting on them. And indeed, in large measure, they have. This has been true because the basic information on which they act comes to them through a large variety of relatively independent institutions. The President and the Congress, like the public press, have to rely for their large scale statistical and economic data on the information that is given to them by the network of sources within the Department of Agriculture and throughout the system of land grant colleges, state extension services and experiment stations, and private research institutions. No disciplined hierarchy defines the questions or determines the answers as this network of independent or semi-independent institutions carries on its work. The farm system is as open to political criticism as the farmer is exposed to economic competition.

But consider the contrast with the field of national defense. Here much of the key information is secret intelligence, and the issues are defined in the process of preparing complex plans

within a disciplined hierarchy. In many of the major problems involved, the world of open politics knows what an issue is only because the professionals have brought it to light simultaneously with a proposed decision. And the decision is not one that, given the pressure of time and the absence of alternatives, the politicians or the public can consider at their leisure, and with confidence that the principle of civilian supremacy makes it equally possible to say yes or no.

To take hold of this problem with any genuine freedom of choice, it is necessary to go back in the time sequence, well before the date when the typical issue arises on which the public now is accustomed to focus its attention. When the ultimatum is delivered on Quemoy or Berlin the public usually has to rely on the plan that the professionals have developed. And so do the Congressmen. But as citizens and voters we need not indulge in self-pity for this reason; we are in a box when the crisis arises, but we are in good company; so indeed are the President, the Secretary of Defense, and the Joint Chiefs—and so on down the line. Much nonsense is talked about the way in which military technology restricts the freedom of democratic action. It is nonsense because it is not technology that restricts freedom of action, but facts. Technology widens the range of possibilities that are open for choice, but only for those who know what they are doing. A man who drinks too much whiskey for twenty years has no right to complain when his doctor gives him unpleasant orders about his liver; a city council that builds a bridge in one spot has no right to complain that its chief engineer will not let it route traffic in another direction. The facts are inexorable; to control them we must make the right decisions at the right time. And for us as laymen, the most important decisions to make are what kinds of experts to hire or train, and what kinds of decisions to ask them to help us make.

As citizens and voters, we should not be getting excited about Quemoy or Berlin. We should be worrying instead not even mainly about the nature of the weapons systems and military forces which determine our ability to meet such crises—those intermediate range problems are best haggled over between military professionals, scientists and engineers, and responsible civilian administrators. What we can worry about as citizens and

politicians in a way that can have some effect is (1) whether we are willing to pay what it costs to do the job, and (2) whether we are creating the kind of over-all organization that—maybe ten years from now—will have devised the military power and the diplomatic posture that we need.

And the judgment about organization should not be made in terms of mere managerial efficiency—and with this I come back to my main point. We have to recognize the limitations on the ability of the public or the Congress or the President, at any one time, to make decisions without regard to the plans that the experts have already drawn up, or without regard to the limits that technology and organization impose on the range of possible choices. But this is not to say that we want to abdicate to the experts, not even on the immediate subjects (like those mentioned above) on which we have little range of free choice. Some matters of military planning and diplomacy must remain secret, but even on them we need to provide for discussion of official policy by people who have full access to secret data but are in positions outside the chain of official responsibility, and free to criticize.

Here is the great advantage of the system of delegation by contractual relations that has grown up within the fields of military and foreign affairs. In the nineteenth century parliamentary system, the shadow cabinet of His Majesty's Opposition maintained a group of men who had had the experience of official responsibility, still retained access to official secrets (this is why they remained Privy Councillors), and could criticize current policy from a point of view that combined independence of thought with the sobering realization that they might again be called to responsibility. Our nearest contemporary equivalent, in the United States, is provided partly by the members of Congressional Committees, who come closer to constituting a career service than do the civilians in the Pentagon. But it is provided partly, too, in the fields of foreign and military affairs by men who are working in the vast network of industrial corporations, university laboratories, and operations research agencies. Many of them have held high official positions and may do so again. Many of them keep up their participation, through a variety of consulting or study group arrangements, in the formulation of official plans. Their access to secret materials, and the independ-

ence of judgment that they can afford because their own institutions do not depend solely on government business, mitigate the evil effects of secrecy on the conduct of military business.

Their status mitigates such effects, but does not prevent them entirely. And it produces a new range of problems which are today virtually ignored, but will doubtless excite political critics if international tensions should ever again relax. These are the problems involved in the relationship, within a particular corporation, of its public and private business. If it depends on weapons development contracts for, say, a third of its business, how can anyone calculate the proper way to distribute costs and benefits between the public and the private sectors of its work? How can anyone appraise the benefits it attains for its private purposes by being kept in the forefront of scientific progress at the expense of government contracts? How can anyone determine whether it is making a fair division of its executive and scientific talent between the two sectors of its business? Who can say whether its enthusiasm in advocating the development or production of a particular weapons system was warranted in the public interest, or whether it was simply lobbying for profit, and thereby distorting our basic military plans and endangering our national security?[5]

It will be hard, when the political pendulum swings and partisan critics use such issues as a basis for attack, to remember and defend the valid arguments on the other side: that an inadequately organized federal government called in desperation for help from our industrial corporations, and by contracting with them took advantage of their accumulated backlog of technology and managerial expertise—assets which the government itself could not have developed so well or so cheaply, if at all. And by their very nature the facts and motives in each case will be hard indeed to judge.

But two things seem clear enough. One is that the nature of our administrative machinery will in the future have a profound effect on the nature of our political and social system, and so we cannot consider problems of organization and management ex-

[5] See James M. Gavin, *War and Peace in the Space Age* (New York, 1958) pp. 255-257, for a statement of an insider's fears along these lines. General Gavin, of course, is one of the best examples of one whose independent industrial position gives him a basis of independent criticism.

clusively from the point of view of internal operating efficiency —especially in the military and scientific fields which are the fastest growing aspects of the federal budget. The second follows from the first—it is that we therefore have all the more need for a trained corps of civilian career administrators who are capable of appreciating these problems in all their complexity, and of considering them independently of partisan points of view.

The fact that policy and administration are inseparable subjects does not lead us to the conclusion that administrators should operate like politicians. On the contrary, it merely increases the difficulty and interest of the problems with which the administrator must deal. And this requires him to bring to those problems an education of the highest level of intellectual quality and a career experience that equips him to think of policy in terms broader and deeper than the partisan concerns of the moment.

If we are interested, either as public officials or as academicians, in education for public administration, we ought to realize how wide a spectrum is involved. We need to train specialists of all kinds—in various aspects of science and technology, in various types of procedures and office methods, in various managerial specialities. But the various management specialties will not provide the highest type of intellectual equipment needed by the administrator, any more than would training in a miscellaneous group of advanced academic specialties. Public administration in its highest reaches—the job of the man who moves into positions of top responsibility at any level of government—is not merely a collection of separate policy issues, any more than it is a collection of specialized techniques of management.

Quite apart from any help they may have had from their university brethren, the better public administrators have been pushed by their responsibilities and by the way in which public and private business are intertwined into seeing their old management specialties in a new depth. Some budgeteers know that their work is no longer merely a special form of accounting; it involves the higher reaches of fiscal and economic policy. Personnel administration comprehends (though the personnel administrator may not) the sum total of our national manpower needs, and the maintenance of a balance in our society between public and private careers. (Look, for example, at the relation

between our military contracting problems and the issue whether we can help an adequate proportion of our best scientists devote themselves to basic research.) The planner needs to think about much more than the problems, which are complicated enough, of applying our best technical knowledge to the development and use of our resources. He is concerned whether we are creating institutions which in the long run can foster the production of the knowledge itself, and of the independent thought that should guide its application. And the organization specialist, instead of contenting himself entirely with production schedules or office layout, should also be grappling, in the higher reaches of federal or even state or municipal administration, with the basic problems of executive-legislative relations and the nature of our federal system. And if he is engaged, in the technical assistance program, in advising foreign governments, he is compelled to consider how parochial, and how restricted to our western culture, have been most of the textbooks on politics and economics and administration which we have crammed down the throats of the unhappy foreign graduate students in American universities for many a year.

Far too few of our administrators, of course, see their problems and their responsibilities in their full depth and complexity. But neither have those of us who have tried to promote their training. We have been all too much inclined to see only the collection of assorted management skills, or only the variety of specialized academic disciplines. For after all, is not the mastery of some one of them the surest way to get on a civil service register, or to write a doctoral dissertation?

But people respond, sometimes, to the challenge of the age, and in America our most urgent challenge is to bring to the top ranks of the public service administrators who can shape the great issues of the future for decision by our constitutional processes, and who can carry out those decisions not only with efficiency, but with a creative view of the future.

OBSCENE LITERATURE AND THE CONSTITUTION

Martin Shapiro

Obscenity and the Law

"I think the test of obscenity is this, whether the tendency of the matter charged as obscene is to deprave and corrupt those whose minds are open to such immoral influences, and into whose hands a publication of this sort may fall."[1]

Lord Chief Justice Cockburn's summation in 1868 began the modern English and American discussion of the law of obscenity, and the history of that law is the ninety year effort of lawyers and judges to refine and apply Cockburn's formula. The Hicklin rule can in fact be separated into three relatively independent problems: "the tendency . . . to deprave and corrupt," "minds open to . . . immoral influence," and "into whose hands publication . . . may fall." The discussion below will consider each of these problems individually, treat the whole book rule which partially replaces Hicklin, examine the somewhat distinguishable question of pornography, and comment on recent Supreme Court decisions in the obscenity field.

The Tendency to Deprave and Corrupt

That which is obscene has a "tendency to suggest impure and libidinous thought,"[2] includes, but is not limited to the perverse,[3] "stirs the sexual impulses"[4] and concerns the scatalogical as well as the sexual.[5] On the surface at least, it appears that "obscene" is, as Justice Reed insists, a word "well understood through long use in the common law."[6] But what is a libidinous thought, and at what point does corruption begin? One of the most striking characteristics of the rulings following Hicklin is the lack of any explicit philosophical, psychological or moral basis for answer-

[1] *Regina v. Hicklin*, 3 QB 360, 371 (1868)
[2] *United States v. Bennett*, 24 Fed Cas 1093, 1104, No. 14 571 (1879)
[3] William B. Lockhart and Robert C. McClure, "Obscenity In the Courts," *Law and Contemporary Problems*, Vol. 20, p. 591 (1955).
[4] *United States v. One Book Entitled "Married Love."* 48 F.2nd 821, 824 (1931)
[5] William B. Lockhart and Robert C. McClure, "Literature, the Law of Obscenity and the Constitution," *Minnesota Law Review*, Vol. 38, p. 321 (1954).
[6] ***Winters v. New York,*** 333 US 507, 518 (1947)

ing these questions. Obviously all sexual thoughts do not deprave or corrupt. But the courts have preferred to speak in terms of public morality, confusing thought and action, rather than considering the critical question of when sexual thoughts actually become immoral or of sufficient social concern to require control.[7]

Professor Chafee has suggested the elimination of this vagueness by the elimination of the Hicklin rule itself and the substitution of the "clear and probable danger" standard.[8] As a Pennsylvania court once put it, matter is obscene only when "there is a reasonable and demonstrable cause to believe that a crime or misdemeanor has been committed or is about to be committed as the perceptible result of the publication and distribution of the writing in question."[9] This test would certainly accord with the Supreme Court's expressed views on the regulation of speech[10] and would have the virtue of being firmly grounded in democratic philosophy rather than resting on vague notions of morality.

But there is no question that the Court has rejected any application of the clear and present danger rule and the philosophy behind it in matters concerning obscenity. Although the constitutional issue has rarely been considered in the lower courts and was not clearly presented to the Court until 1948,[11] it has repeatedly ruled that obscenity is not within the area of constitutionally protected speech.[12] These exclusions of obscenity from the protection of constitutional guarantees were, for the most part, dicta in cases not directly dealing with obscenity. Their presence represented in several instances a rather casual

[7] William B. Lockhart and Robert C. McClure, "Obscenity In the Courts," *Law and Contemporary Problems*, Vol. 20, p. 590 (1955).

[8] Zechariah Chafee, *Government and Mass Communications*, Vol. I, pp. 59-60 (Chicago, 1947). Clear and present or probable danger will, in this paper, serve as a shorthand term for the issues clustered around the distinction between incitement to thought and incitement to action. Nothing is implied concerning the current validity of the term itself.

[9] *Commonwealth v. Gordon*, 66 D & C 101, 156 aff'd sub nom. *Commonwealth v. Feigenbaum*, 166 Pa Super 120 (1950)

[10] *American Communications Association v. Douds*, 339 US 382, 395 (1949); *Herndon v. Lowry*, 301 US 242, 255 (1931)

[11] *Doubleday & Company v. New York*, 335 US 848, without opinion (1948)

[12] *Near v. Minnesota*, 283 US 697, 716 (1930); *Chaplinsky v. New Hampshire*, 315 US 568, 571-2 (1941); *Hannegan v. Esquire Inc.*, 327 US 146, 158 (1945); *Winters v. New York*, 333 US 507, 510 (1947); *Beauharnais v. Illinois*, 343 US 250, 266 (1951)

attempt to sketch out the boundaries of first and fourteenth amendment protection. Even the more careful attempt in Winters is supported by citations concerning obscene speech rather than writing.[13] The four to four split in the Doubleday case seemed to indicate that, when directly faced with the problem of an allegedly obscene writing, the Court was reluctant to be guided by these dicta, but a recent opinion specifically upholds them.[14]

The Court's pronouncements, although excluding obscenity from constitutional protection, cannot prevent first and fourteenth amendment questions from arising in these cases. All speech and writing raises such questions and the Court itself insists that determinations of obscenity must be made according to standards conformable with speech and press protection.[15] Only after such a determination has been made are utterances excluded from protection.

Exclusion then does not really avoid the constitutional issues. It merely transplants them to the area of determining whether a given work is obscene or not. Such determination, like all determinations of the permissible limits of free speech and press, must ultimately rest on calculations of social value and its opposite. Perhaps the clear and present danger formula is not appropriate in this area, but its possible inappropriateness does not relieve the Court of the responsibility for arriving at some standard for calculating the disvalue side of the balance in matters of sexual expression. Such a standard can only be constructed by careful examination of the actual social harmfulness of lustful thought, not by the assumption of that harmfulness nor by surrender to legislative judgments that such harmfulness exists. Until the term "obscenity" is applied only to those expressions whose harm outweighs the social desirability of free expression and the social disvalue of censorship, exclusionary formulas can yield no sound meaning.

The Court in using these exclusionary formulas has placed itself in a very peculiar position. It has held that "The freedom of

[13] William B. Lockhart and Robert C. McClure, "Literature, the Law of Obscenity and the Constitution," *Minnesota Law Review*, Vol. 38, p. 355 (1954).

[14] *Roth v. United States* together with *Alperts v. California*, 354 US 476, 486 (1957), hereafter cited as *Roth v. United States*.

[15] *Roth v. United States*, 354 US 476, 488 (1957)

speech and of the press guaranteed by the Constitution embraces at the least the liberty to discuss publicly and truthfully all matters of public concern . . .,"[16] that "Freedom of discussion . . . must embrace all issues about which information is needed . . . to enable members of society to cope with the exigencies of their period . . ."[17] and that ". . . the right of free speech and free press are not confined to any field of human interest. . . ."[18] It has even been held that publications of no value to society are protected.[19] At the same time it has adopted the whole book rule[20] which implies that the value to society of the publication shall be balanced against the quantity of obscenity contained in it. Only if the former is greater than the latter will it be judged not obscene and entitled to protection.

In other words a book on any other vital subject, indeed a book on any subject, vital or not, is fully protected and can only be controlled if it threatens to incite to some illegal action. But a book concerning sex is not protected unless its value to society outweighs its incitement, not to actions, but to lustful thoughts. By formally excluding obscene materials from first amendment protection, the Court has relieved the censor of the necessity of satisfying the first amendment requirement that word be linked with deed. The censor is left with the far easier task of demonstrating a relation between word and thought. Once he has satisfied the court as to the libidinous thought arising from the allegedly obscene words, he is exempted from the further task which would normally be imposed on him; that of showing a final link between the thought and some action subject to legal control.

In short, governmental restrictions on freedom of expression are not subjected to as strict a constitutional test when concerned with certain expressions of great value as they are when controlling expressions of no value. The wide popularity of sex literature and varying opinions on sexual issues require the very protection which is denied if the free discussion which is essential to the discovery of truth is to occur. The clear and present

[16] *Thornhill v. Alabama*, 301 US 88, 101 (1939)
[17] *Thornhill v. Alabama*, 310 US 88, 102 (1939)
[18] *Thomas v. Collins*, 323 US 516, 531 (1944)
[19] *Winters v. New York*, 333 US 507, 510 (1947)
[20] See p. 29 below

danger rule may not suffice, but surely some other equally strict rule should be constructed to replace it in this field.

It can be argued that the Court has long recognized the rights of the states under the police power to concern themselves with matters of public morality. But constitutionally approved state action in this field has generally involved some fairly evident detriment to public morality. Prohibition laws can, aside from the enforcement problem, be shown to have some direct relation to drunkenness and the property damage, crime and public expense which follow from it. Anti-gambling laws can be shown to prevent the protector of the family from flinging away his last penny and leaving his children to starve, and wages and hours legislation may end excessively long hours and low wages which lead to ill health.

Obscene publication laws, under the present definition of obscenity, are not linked to any such palpable evil. They are, so their supporters allege, designed to prevent people from having thoughts about sex. That sexual thoughts are personally degrading or destructive to the fabric of society is hardly self-evident in this post-Freudian age. It would be difficult to demonstrate that writings or pictures significantly increase or decrease the quantity of sexual thought in the community. A picture may well be worth a thousand words, but, in this field, a tight sweater is worth many thousands of either. Sex appeal, i.e. excitation of lustful thoughts, is one of the most prevalent characteristics of our society. It is simultaneously our most widely advertised product and our most widely used means of advertising. In this ocean of sex, an occasional drop of the literary variety is hardly perceivable.

At this point corruption of youth usually becomes the battle cry of the censor. But in the one extensive study made of the effect of written and other material on youth, the effects of reading appear minimal.[21] It also seems clear, although there is little empirical evidence, that those most likely to be corrupted are those least likely to read. It may be true that the blatantly pornographic book or ten pager has some effect and, in the increased circulation which might follow from the destruction of censorship laws, a considerable one, but there are some fairly

[21] Howard M. Bell, *Youth Tell Their Story* (Washington, 1938), pp. 41-42.

workable standards for differentiating this kind of material from other kinds which presently fall under the obscenity ban.[22]

Another rationale for sex censorship which has been used by the courts is that sexually nasty publications are not condemned because they incite impure thoughts, but because they offend the moral concepts of the people as a whole. Hand suggests in the Kennerley case that society has the right to establish codes of right conduct in literature as well as in other forms of community conduct.[23] This offensiveness or shock principle is really derived from the field of obscene speech and indecent exposure. As Chafee points out, shock rarely results from books.[24] People likely to be shocked are not likely to read the kinds of books that might shock them, and if by accident they do stumble on an objectionable passage, they can stop reading. A book, unlike a nudist, is between covers. One doesn't have to view the sexual parts unless one wants to. The shock value theory succeeds in escaping the Hicklin doctrine of inciting impure thought. Undoubtedly that is why Hand adopted it in Kennerley. But ignoring social realities is not the best road to establishing sound rules.

No matter what rationale is employed, any valid argument for government action to control obscene literature must rest on the evil effects of such literature on society. There is no proof that the arousing of sexual desires is harmful to society, ". . . no sane man thinks socially dangerous the arousing of normal sexual desires. . . ."[25] Even in those instances where it is claimed that excessive or unnatural desires are aroused, what is often meant is that new sexual standards contrary to those presently accepted are being expounded. There is no reason why advocacy of unorthodox sexual standards should be prohibited while advocacy of unorthodox political standards is sanctioned. The right of citizens of a democracy to advocate and effectuate changes in community standards can hardly be questioned.

There is only one instance in which advocacy or description of unorthodox sexual behavior might reasonably fall outside of

[22] See p. —— below
[23] *United States v. Kennerley*, 209 Fed 119 (1914); See also *Parmelee v. United States*, 113 F. 2d 729 (1941); *State v. Lerner*, 81 NE 2d 282 (1948)
[24] Zechariah Chafee, *Government and Mass Communication*, Vol. I, p. 56 (Chicago, 1947).
[25] Frank concurring in *Roth v. Goldman*, 172 F 2d 783, 792 (1944)

the need for free advocacy of change. The distinction between advocating violation of a moral standard and advocating change to a new standard is a subtle but very necessary one. While the presentation of new standards of behavior is usually an attempt to perfect the social order, the advocacy of random infringement of norms leads, both logically and practically, to the destruction of the social order itself. It is inimical not only to a given society but to all societies. What Kaplan calls the "obscenity of the perverse,"[26] the delight in sin for its own sake, recognizes the present standards and gains its enjoyment from the violation of the very norms it acknowledges. This type of unorthodox expression may well require legal control if the link between advocacy and action can be established. Other regulation infringes on that "Right of expression beyond the conventions of the day [which] is the very basis of a free society."[27]

Whose Minds Are Open

In many ways the most constricting part of the Hicklin test is the minds open criterion, for it makes the young and the perverted the measure of the minds of the community. Yet this practice was so entrenched in American courts that in the Kennerley case[28] Justice Hand felt bound to support it although, as noted above, he suggested a new standard, "the present critical point in the compromise between candor and shame at which the community may have arrived here and now."[29] Even though a community standards test rests on the shock value argument and is, therefore, open to grave objections, its practical effect is to liberate the courts from the severity of the Hicklin rule. Several courts have since recognized Hand's formula and it is echoed in the latest Supreme Court decision.[30]

Another and more widely used means of circumventing or rather repudiating the Hicklin rule was introduced by Judge

[26] Abraham Kaplan, "Obscenity As an Esthetic Category," *Law and Contemporary Problems,* Vol. 20, pp. 544 and 556 (1955)

[27] Frankfurter concurring in *Hannegan v. Esquire Inc.,* 327 US 146, 159-60 (1945)

[28] *United States v. Kennerley,* 209 Fed 119 (1914)

[29] *Id.* at 121

[30] *Roth v. United States,* 354 US 476, 489 (1957); *Parmelee v. United States,* 113 F 2d 729, 731-32 (1941); *Commonwealth v. Isenstadt,* 62 NE 2d 840, 844 (1945)

Woolsey in the *Ulysses* case.[31] The tendency of material to inspire lustful thoughts is to be determined on the basis of the *homme moyen sensuel* rather than the young or abnormal. This *homme moyen sensuel* is not merely the average man but plays ". . . the same role . . . as does the 'reasonable man' in the law of torts. . . ."[32] Although the question of jury trial will be discussed in connection with the recent Supreme Court decisions, it should be noted here that the Woolsey doctrine is not just an attempt to replace a particularly offensive standard with a more lenient one, but to frame a test compatible with his desire to eliminate juries from obscenity cases.[33] The *homme moyen sensuel* doctrine has been widely adopted, but usually in its average man aspect rather than as a device to avoid jury trial.[34]

The community standard and the average man tests are quite similar and, in actual judicial practice may become identical, but, as Kinsey's work has shown, there may be a vast difference between the average man's thoughts or actions and the standards nominally accepted by the community. Material which closely corresponds with prevalent thought and action and thus has no tendency to deprave the average man may, when compared with acknowledged community standards, seem shocking indeed. Of the two, the community standards test is, at least potentially, the more restrictive.

The much applauded Frankfurter decision in *Butler v. Michigan*,[35] holding that censorship which reduced the reading matter available in the community to that suitable for fourteen year olds violates due process, echoes a recent British attempt to deal with the Hicklin rule.[36] It is not necessarily a great new blow for literary freedom. But it does appear to be the first affirmation by the Supreme Court of the average man or community standard devices in use by lower courts since the Kennerley and *Ulysses* decisions. However, Frankfurter's broad attack on due

[31] *United States v. One Book Entitled 'Ulysses,'* 5 F. Supp. 182 (1934)
[32] *Id.* at 182, 184
[33] *Id.* at 183
[34] See *Parmelee v. United States,* 113 F 2d 729, 730 (1941); *Walker v. Popenoe,* 149 F 2d 511, 512-13 (1945); *Sunshine Book Company v. Summerfield,* 128 F. Supp. 564, 567 (1955); *American Civil Liberties Union v. Chicago,* 121 NE 2d 585, 591 (1954)
[35] 352 US 380 (1957)
[36] *Regina v. Martin Seeker Warburg Limited,* 2 All ER 683 (1954)

process grounds rather than by definition of obscenity may very well be intended as a blow at the many statutes which in addition to obscenity introduce corruption of youth as a standard of censorship. Such statutes, in so far as they reduce the reading level of the whole community to that of an adolescent, may now be considered violations of due process.

Into Whose Hands

"Whose minds are open" and "into whose hands" are obviously closely related tests. Both concern the persons who are to be considered when determining the tendency of the matter to incite lustful thoughts. On the whole, however, the latter has been the more liberal of the two and with some modifications is still used.

Several courts have taken their cue from Hicklin itself, ". . . into whose hands a publication *of this sort* may fall. . . ."[37] They have considered the type of book, price, and manner of advertising and sale.[38] If the material is mailed, the effect on the addressees rather than the general public may be considered.[39] There has been a tendency to consider the effects of a publication on its probable audience rather than the general public or the chance adolescent reader. The Hicklin formula is thus altered from into whose hands the publication *may* fall to into whose hands the publication *is likely* to fall.[40] While this approach has delivered the courts from the embarrassment of having to deal with gynecology texts as if they were "stories that you will like," it cannot be stretched too far. As long as most books remained high in price so that it might be argued that only persons of high income and presumably cultural rather than salacious motives could obtain them, the doctrine provided some protection for legitimate literary works. The advent of the paper back has destroyed any argument based on availability and cost

[37] *Regina v. Hicklin*, 3 QB 360, 371 (1868), emphasis added

[38] *United States v. Rebhuhn*, 109 F 2d 512 (1940); *Roth v. Goldman*, 172 F 2d 789 (1944); *In re* Worthington, 30 NY Supp. 361 (1894); *People v. Pesky* 243 NY Supp. 193 (1930); *People v. Fellerman*, 276 NY Supp. 198 (1935)

[39] *United States v. Levine*, 83 F 2d 156, 158 (1936)

[40] *United States v. Levine*, 83 F 2d 156, 157 (1936); *United States v. 31 Photographs*, 156 F Supp. 350, 354 (1957); *People v. Creative Age Press*, 79 NYS 2d 198, 201 (1948)

alone. The doctrine will have to be more fully developed on other grounds if it is to retain its protective value.

Pornography

The distinction between obscenity and pornography, at first glance somewhat vague, does, unlike most literary-legal distinctions have some basis in esthetics. The concept of psychical distance is a familiar one in the psychology of art. It contains two somewhat separable notions. In one sense psychical distance denotes the removal of the object of esthetic experience from "connections of instrumental nature, or functional relationships to use, to human behavior, or to ethical abstractions." Objects are treated as "terminal, as ends rather than as means."[41] On the other hand psychical distance indicates not only that the art object is isolated from the practical or instrumental aspects of life, but that the observer is, to a certain extent, isolated from the object. While the observer feels the same emotions as those depicted in the object he does not feel them with the same intensity. We may despair with Juliet but not sufficiently to commit suicide with her. One author notes that the esthetic experience "(1) lacks all or, at least many of the sensory stimuli and instinctive reflex dynamics of the . . . [act depicted] . . .; (2) is under complete, or nearly complete, voluntary control; (3) is greatly reduced in intensity. These three differences constitute the psychical distance between an emotion in art and its represented source in real life."[42] Pornography seeks to break down this psy-

[41] See Gilbert Brighouse, "A Study of Aesthetic Apperception, *Psychological Monographs*, Vol. 51, No. 5, pp. 1-2 (1939). The term was introduced by Edward Bullough in 1912. See E. Bullough, "Psychical Distance As a Factor in Art and an Aesthetic Principle," *British Journal of Psychology*, Vol. 5, (1912) p. 87; Lester D. Longman, "The Concept of Psychical Distance," *Journal of Aesthetics and Art Criticism*, Vol. 6, p. 34 (1947).

[42] Albert Pepper, "Emotional Distance in Art," *Journal of Aesthetics and Art Criticism*, Vol. 4, p. 238 (1946). Pepper offers the hypothesis that esthetically felt emotions are "apprehensive emotions based on supposals" (p. 237). By this he means that the esthetic experience causes the observer to imagine that he is about to enter the situation presented. The depiction of a man in a dentist's chair causes the observer to suppose or recreate within himself the apprehensive emotions which he felt when, at some previous time, he was anticipating a trip to the dentist. These apprehensions in turn were based on the actual suffering he had experienced in the chair at an even earlier date. The esthetic experience is thus two stages, the apprehensive or

chical distance. It is not presented as an end in itself but as a means to incite emotions of the same intensity as those depicted. "It is not itself the object of an experience, esthetic or any other, but rather a stimulus to an experience not focused on it. It serves to elicit not the imaginative contemplation of an expressive substance but rather the release in fantasy of a compelling impulse."[43] Thus, in a sense, pornography is the only obscenity. It alone incites lustful thoughts. Some courts have taken this view by holding that books of literary merit fall outside the obscenity laws.[44] If works of literary merit fall outside the statutes, then only works of pornography fall within them. Pornography, unlike obscenity, is not only readily definable in theoretical terms but lends itself to a fairly workable set of practical standards. A book by a known author bearing the hallmark of an established publisher is not likely to be pornographic, i.e., designed as a stimulus to sexual fantasy. An unsigned pamphlet distributed by an unknown publisher and consisting entirely or primarily of sex episodes is very probably presented as just such a stimulus.

It is not being argued here that either the esthetic or practical tests of pornography provide an absolutely precise means of dealing with individual cases. There must inevitably be disputes over whether a specific work is under-distanced and important works by young authors frequently lack the dignity of hard covers and esteemed publishers. But the very objection that pornography like obscenity lacks a hard and fast definition indicates the value of emphasizing pornography as the evil to be controlled. Judges must constantly bisect a continuum ranging from the most blatantly dirty picture to the most staid ladies' magazine. Because of the inevitable lack of precise standards no single point of bisection can be located. Rather a kind of no man's land is established and works falling within a certain range along the continuum risk condemnation although, at any given time, a certain number will survive. If obscenity is used as the standard of condemnation, large numbers of esthetically valu-

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anticipatory and the imaginative, removed from actual experience and therefore considerably reduced in intensity.

[43] Abraham Kaplan, "Obscenity As an Esthetic Category," *Law and Contemporary Problems*, Vol. 20, p. 548 (1955)

[44] *People v. Viking Press*, 264 NY Supp. 534 (1933); *People v. Miller*, 279 NY Supp. 583 (1935)

able works must inevitably get into difficulties simply because the fluctuating and indefinite area of risk lies at the segment in the continuum where the decent merges with the indecent. The use of the pornography standard shifts this risk area far enough toward the indecent end of the scale to reduce the perils to genuine artistic efforts while allowing the continued control of dirt for dirt's sake.

In short the distinction between pornography and obscenity may in particular instances be almost as difficult to establish as that between obscenity and decency but the former is less likely to inhibit creativity and is just as effective in inhibiting the dirty book trade. While the courts in general have not adopted the view that pornography is the only material falling under the statutes, the distinction between pornography and artistic description of sexual matters is the foundation on which the whole book rule is built.

The Whole Book Rule

". . . whether a publication taken as a whole has a libidinous effect . . ."[45] This in brief is the whole book rule. It is useful, before plunging into the implications of the rule, to begin with this simple definition because it illustrates what the whole book rule is not. It is not a refutation of the Hicklin test; it is not a holding that only pornography is obscene; it is not, in spite of the cheers from literary circles, the emancipation of the artist from the heavy hand of the law.

The whole book formula retains the definition of obscene as exciting sexual impulses or lustful thoughts and provides a new means of handling evidence rather than a new basic rule. Although specifically rejected in *United States v. Levine*,[46] the Hicklin test is still very much alive both in its definition of obscenity in terms of thought and, often modified, as the basic formula by which many jurisdictions have continued to be guided at least until the recent Supreme Court decisions.[47]

Concurrent with the Hicklin rule, the practice of citing

[45] *United States v. One Book Entitled "Ulysses,"* 72 F 2d 705, 707 (1934)

[46] *United States v. Levine*, 83 F 2d 156, 157 (1936)

[47] *United States v. Barlow*, 56 F Supp. 795 (1945); *Sunshine Book Company v. Summerfield*, 128 F Supp. 564 (1955); *People v. Dial Press*, 48 NYS 2d 480 (1944); *State v. Mac Sales Company*, 263 SW 2d 860 (1954)

marked passages in the crown complaint had grown up in England and, although there was little uniformity in this country, it was common practice to admit isolated passages as evidence. The fiasco in Massachusetts[48] over Dreiser's *American Tragedy* in which the judge insisted that isolated passages alone be considered because the book was too long to read to the jury resulted in the wholesale rejection of the practice.

United States v. Bennett[49] had been the principal federal decision sanctioning the use of isolated passages to prove obscenity. The Dennet decision[50] had weakened but not overthrown this precedent by holding that it was not the intent of Congress in banning obscene books from the mails to exclude decent sex instruction from mailing privileges although the books in question obviously contained passages which, taken out of context, might incite lustful thoughts.

A New York Court specifically invoked the whole book standard[51] in 1930, but it was the *Ulysses* decisions of 1933 which firmly established the rule. Woolsey's decisions in the district court[52] actually presented two lines of argument. The first relies on the notions of pornography described above. It must be determined if the author's intent was pornographic, that is if the work was written to exploit obscenity. Does the work contain dirt for dirt's sake? This argument is weak in so far as it relies on the author's intent. If the question is, does the matter incite lustful thoughts, the author's intentions are unimportant. From a theoretical standpoint, the author's intentions are of no importance at all. There is a sharp distinction between subjective and objective intent. Artistic experience concerns participation between the object, a picture or book for instance, and the observer. The artist is not present; it is the intention or content of the object itself and the response of the viewer or reader which constitute the esthetic experience. The fact that Dostoevsky wrote *Crime and Punishment* only to meet the terms of a ruthless publisher has nothing to do with the presence or absence of artistic value in that work.

[48] *Commonwealth v. Friede,* 171 NE 472 (1930)
[49] *United States v. Bennett,* 24 Fed Cas 1093, No. 14, 571 (1879)
[50] *United States v. Dennet,* 39 F 2d 564 (1930)
[51] *Halsey v. New York Society for Suppression of Vice,* 136 NE 219 (1922)
[52] *United States v. One Book Entitled 'Ulysses,'* 5 F Supp. 182 (1934)

However, if Woolsey's argument were converted from subjective to objective intent, it would have a great deal of force, and Woolsey has actually used the objective standard without realizing it. He determines that the objectionable passages in *Ulysses* are not dirt for dirt's sake because they are necessary to the literary method employed. In other words, they are unobjectionable because they are demanded by the structure and style of the object itself. Nevertheless Woolsey's own confusion on this matter has resulted in the formal rejection of the intent standard although there is no question that many judges and juries are influenced by it.[53]

Woolsey's second line of argument rests on the peculiar nature of the work in question. The whole book test ". . . is the only proper test of obscenity in the case of a book like 'Ulysses' which is a sincere . . . attempt to devise a new literary method for the observation and description of mankind. . . ."[54] Since *Ulysses* is an attempt to completely describe man, it must describe his vulgar and lustful, as well as his virtuous, sides. The whole book rule is being enunciated here, not as a general one, but as necessary to fair treatment of a particular kind of book, the stream of consciousness novel.

Justice Augustus Hand in his affirmation of the Woolsey decision finds that, "This book as a whole is not pornographic and, while in not a few spots it is . . . obscene, it does not, in our opinion tend to promote lust. It is settled . . . that works of psychology . . . are not within the statute though to some extent and among some persons they may tend to promote lustful thoughts. We think the same immunity should apply to literature . . . where presentation . . . is sincere and erotic matter is not introduced to promote lust and does not furnish the dominant note. . . ."[55]

Acceptance of works which ". . . contain matter which is obscene . . ." if the ". . . erotic matter is not introduced to promote lust . . ."[56] carries us perilously close to the intent doctrine which Hand denounces in another place in this deci-

[53] William B. Lockhart and Robert C. McClure, "Literature, the Law of Obscenity and the Constitution," *Minnesota Law Review*, Vol. 38, p. 350 (1954)
[54] *United States v. One Book Entitled 'Ulysses,'* 5 F Supp. 183, 184-85 (1934)
[55] *United States v. One Book Entitled 'Ulysses,'* 72 F 2d 705, 707 (1934)
[56] *United States v. One Book Entitled 'Ulysses,'* 72 F 2d 705, 707 (1934)

sion. But Hand is, I think, only choosing a rather unfortunate way of holding that questionable matter must be evaluated in terms of its integration and necessity to the work as a whole. Nevertheless, the decision at this point approaches a holding that only pornography comes under control.

But Hand obviously did not intend to go that far. "Dominant note" is the key expression here. Hand accepts Woolsey's position that *Ulysses* deserves special treatment because of its peculiar and experimental nature. But his real concern is with the problem of protecting not new and daring works (his distaste for *Ulysses* is apparent) but the classics. The Bennett doctrine of considering isolated passages ". . . would exclude much of the great works of literature . . ." and, therefore, must be rejected.[57]

Thus Hand starting from the classic and Woolsey from the experimental meet at the whole book rule, a doctrine which allows them to maintain the definition of obscenity as the tendency to promote lustful thought without having to condemn works of obvious literary merit. But is the whole book rule formulated in the *Ulysses* cases and used by most courts thereafter[58] really compatible either with the nature of the material or with the lustful thought definition of obscenity? The novel is a time not a space form. Unlike a picture, it does not attempt to create one instantaneous and unified impression, but rather a series of impressions. The fact that serialization was the principal mode of novel publication from the time of Richardson to that of Dickens is sufficient proof of its temporal aspects. Any assertion that only the total impression left by a book is significant is at odds with the whole conception of the novel form.

People do not read a whole book at one sitting, nor even whole passages. Such a distinct entity as Molly's soliloquy may be only half read at a given time. Even a reader of great stamina may soon tire of that mass of unpunctuated verbiage. But assuming that most readers had the time and endurance to read any novel, let alone *Ulysses*, at a sitting, the test comes no closer to

[57] *United States v. One Book Entitled 'Ulysses,'* 72 F 2d 705, 708 (1934)

[58] *United States v. Levine*, 83 F 2d 156 (1936); *Parmelee v. United States*, 113 F 2d 729 (1941); *Walker v. Popenoe*, 149 F 2d 511 (1945); *American Civil Liberties Union v. Chicago*, 121 NE 2d 585 (1954); *Commonwealth v. Isenstadt*, 62 NE 2d 840 (1945)

reality. Readers do not enter a trance, forbearing all thought until the material they are reading is completed. They have their thoughts as they read. If, as Hand admits, some passages of *Ulysses* are obscene, then, by definition, some readers have lustful thoughts when they read those particular passages. The lustful thoughts, the evil that the legislature presumably desires to prevent, have occurred. Whatever impression the reader may get from the book as a whole will come too late to prevent their occurrence.

It may well be argued that both Woolsey and Hand are interpreting a statute concerning whole books and thus are perfectly correct in dealing with whole books regardless of the realities of book reading. Both, in fact, stress statutory interpretation.[59] But the whole book rule is now regarded as a general test not simply an interpretation of the customs statute.[60] At the point the rule becomes general, it finds itself very far indeed from the realities on which general rules supposedly rest.

In spite of their attempts to find that *Ulysses* does not inspire lustful thoughts, it is apparent that Woolsey and Hand, and the other courts which have adopted the rule, are at bottom concerned with weighing the social value of the literary qualities in the work against the social disvalue of the lustful thoughts which may be incited by it. Three difficulties are immediately evident in this kind of enterprise.

First, as noted earlier, while the whole book rule is used in connection with the nominal exclusion of obscenity from constitutional protection, the weighing will be between social value and incitement to thought where the subject matter is sex, but between social value and incitement to a substantive evil when most other subjects are involved.

Second, there is a strong presumption that the legislatures which have made no provisions for excepting works of high literary merit from their obscenity regulations feel that the evils of lustful thought are greater than the values gained from such

[59] *United States v. One Book Entitled 'Ulysses,'* 5 F Supp. 182, 184 (1934); *United States v. One Book Entitled 'Ulysses,'* 72 F 2d 705, 706 (1934)

[60] *Roth v. United States*, 354 US 476, 489 (1957). Two recent decisions, *State v. Lerner*, 81 NE 2d 282 (1948) and *New American Library of World Literature v. Allen*, 114 F Supp. 823 (1954) suggest that the rule is so entrenched that legislative attempts to establish a standard based on portions rather than the whole of a work will be viewed as unconstitutional.

works. It hardly befits the courts to question those judgments unless they are willing to examine the whole question of whether lustful thought is a social evil justifying control.

Thirdly, the use of literary merit on the social value side of the balance opens up grave questions of judicial modesty. Courts do not have special competence as literary critics.[61] This is not to say that the balancing of social value against harm should be abandoned, but rather that literary merit is not the social value which should be considered. The courts in considering political doctrines do not weight their individual merits. They consider the value to society of the free expression of political beliefs. If the courts insist upon using the whole book rule, they should weigh not the value of the work, but the value to society of free literary expression and experimentation.

Recent Supreme Court Cases

Of the two cases concerning obscenity recently decided by the Court,[62] one deals principally with the question of prior restraint, the other with more general questions. Kingsley is not examined at length here because the problem of prior restraint is beyond the scope of this discussion. Approval of a New York statute[63] providing an injunctive as well as a criminal law method of dealing with obscenity emphasizes the Court's previous position that protection against prior restraint is not unlimited.[64] The Court has not, however, precisely specified those limits and apparently prefers to continue on a case by case basis rather than announcing a general rule.

[61] The courts have differed over the admissability and decisiveness of reviews and testimony by critics. See *United States v. Levine*, 83 F 2d 156 (1936); *United States v. Two Obscene Books*, 92 F Supp. 934, 99 F Supp. 760 (1951); *Commonwealth v. Isenstadt*, 62 NE 2d 840 (1945); *People v. Brooklyn News Company, Inc.*, 26 LW 2641 (1958).

[62] *Roth v. United States*, 354 US 476 (1957); *Kingsley Books v. Brown*, 354 US 436 (1957). For other comments on the recent cases see L. B. Schwartz, "Criminal Obscenity Law," *Pennsylvania Bar Association Quarterly*, Vol. 29, p. 8 (1957); H. H. Foster, Jr., "Comstock Load—Obscenity and the Law," *Journal of Criminal Law*, Vol. 48, p. 245 (1957); B. J. Rubenstein, "Obscenity," *Brooklyn Law Review*, Vol. 24, p. 49 (1957); P. M. Carden, "Note: The Supreme Court and Obscenity," *Vanderbilt Law Review*, Vol. 11, p. 585 (1958); R. I. Daggett, "Note: Recent Decisions Approve Decency Statutes," *University of Cincinnati Law Review*, Vol. 27, p. 61 (1958).

[63] *New York Code of Criminal Procedure*, Sec. 22 (a)

[64] *Near v. Minnesota*, 283 US 697, 716 (1930); *Joseph Burstyn Inc. v. Wilson*, 343 US 495 (1951)

In the Roth case, the Court makes it first decision directly concerning first and fourteenth amendment protection for allegedly obscene materials. It holds that ideas having even the slightest redeeming social importance are normally protected, but that obscenity is without such importance. It is, therefore, not within the area of constitutionally protected speech or press. Use of the clear and present danger standard is specifically rejected.[65] But sex and obscenity are not synonymous. A standard must be provided which protects discussion of the former since it is one of the vital problems of society.

That standard is, ". . . whether to the average person, applying community standards, the dominant theme of the material taken as a whole appeals to prurient interest. . . ."[66] Appealing to prurient interest is defined as ". . . having a tendency to excite lustful thoughts. . . ."[67] Since the Court quotes with approval a summation of the lower court holding the jury to be the sole assessor of the conscience of the community,[68] it apparently wishes a jury to apply this test.[69]

No clearer criticism can be offered of the Court's exclusion of obscenity from constitutional protection than that of Justice Harlan in his Roth opinion.

> The Court seems to assume that "obscenity" is a peculiar genus of "speech and press" which is as distinct, recognizable, and classifiable as poison ivy is among other plants. On this basis the constitutional question before us simply becomes, as the Court says, whether "obscenity," as an abstraction, is protected by the first and fourteenth amendments, and the question whether a *particular* book may be suppressed becomes a mere matter of classification, of "fact" to be

[65] *Roth v. United States*, 354 US 476, 486 (1957)
[66] *id.* at 489
[67] *id.* at 489 footnote 20
[68] *id.* at 490
[69] In spite of Woolsey's suggestions, juries have generally been held to perform a necessary function in obscenity cases. See *United States v. Clarke*, 38 Fed 500 (1889); *United States v. Dennett* 39 F 2d 564 (1930); *United States v. Levine*, 83 F 2d 156 (1936); *Parmelee v. United States*, 113 F 2d 729 (1941); *Commonwealth v. Isenstadt*, 62 NE 2d 840 (1945). However, it would be incorrect to hold that the Supreme Court deems a jury essential to determination of obscenity. The Court was not directly faced with the jury question in Roth. In Kingsley, decided the same day, it did not find a determination of obscenity made without a jury to be invalid although Justice Brennan in dissent found this point crucial.

entrusted to a fact-finder and insulated from independent constitutional judgment.[70]

The rejection of the clear and present danger standard without the provision of any substitute leaves the whole book doctrine in the relatively weak state described above. The failure of the majority of the Court to deal with the distinction made in the Draft Law[71] between exciting to lustful thought and appealing to prurient interest indicates their unwillingness to grapple with the basic problem of determining what social evils result from obscenity and what degree of control is necessitated by such evils.

The Court's definition of obscenity contains three distinct factors, "dominant theme of the material taken as a whole," "average person," and "community standards." The inclusion of the dominant theme factor is, of course, a ratification of the whole book doctrine used in most jurisdictions since 1933 and continues the difficulties inherent in that doctrine. The adoption of the average man standard was almost inevitable given the history of obscenity law in this country. It remains to be seen whether its acceptance will bar the use of the probable audience formula which has been of great value in certain instances. The interjection of the community standards or common conscience of the community formula is a rather unfortunate one. Such a test is, as noted above, potentially a far greater restriction of freedom of expression than the average man formula. In addition, it rests on shock value and the amount of shock generated by books hardly seems a harm great enough to require restraint.

Shock or offense to the community is in fact quite a different test than appeal to prurient interests. The latter requires a positive promotion of man's baser feelings, the former only an offense to his finer ones. The Solicitor General has already run afoul of this internal contradiction and seems to have succeeded in his attempt to get the Court to clarify its position by reemphasizing appeal to prurient interests as its basic test.[72]

[70] *Roth v. United States*, 354 US 476, 497 (1957), (concurring in Alperts, dissenting in Roth).

[71] *Model Penal Code*, Sec. 207.10 (2) [tent. Draft No. 6 1957]

[72] *New York Times*, November 20, 1957, p. 30; *Mounce v. United States*, 247 F 2d 148, judgment vacated 355 US 180 (1957) [*per curiam*]

The exclusion of obscenity from constitutional protection and its definition in terms of lustful thought were certainly in line with the majority of previous decisions. While some hope had been expressed before the Roth case that the Court would take a bolder stand,[73] its recent decisions do not constitute serious blows to freedom of speech and the press. The very entrance of the Court into this field, when considered in the light of its recent history of defense and extension of civil rights safeguards, augurs well for future constitutional protection in obscenity questions. The whole book rule, in spite of its weakness, offers a fair degree of protection although its liberality depends more on the courts that administer it than on the test itself.[74]

The Roth decision is disappointing, however, because it checks the attempts of certain lower courts to emphasize pornography as the evil to be controlled and to hold that books of genuine literary merit fall outside the obscenity statutes.[75] It is possible that in the future the Court may find that its exclusion of obscenity from constitutional protection raises more questions than it answers. At that time the doctrine that pornography is the only legally obscene matter requiring control will present itself as a possible alternative to the recent rulings.

The replacement of the obscenity by the pornography standard could be effected in one of three ways. The Court could maintain its formula of exclusion but define obscenity in such a way as to exclude only pornography. It could abandon exclusion and hold that the clear and present danger doctrine is not appropriate to this field, but that pornography is material having such a substantively harmful effect as to warrant control. A third alternative would be the substitution of the probable audience for the average man test. The probable audience of pornography, due to its mode of publication and sale, is an especially receptive one. The probable audience of most work which is

[73] William B. Lockhart and Robert C. McClure, "Literature, The Law and the Constitution," *Minnesota Law Review,* Vol. 38, pp. 390-95 (1954); June A. Murray, "Statutory Innovation in the Obscenity Field," *Buffalo Law Review,* Vol. 6, pp. 315-16 (1956-57).

[74] Leo M. Alpert, "Judicial Censorship of Obscene Literature," *Harvard Law Review,* Vol. 52, p. 64 (1938).

[75] *Commonwealth v. Gordon,* 66 D&C 101 aff'd sub nom. *Commonwealth v. Feigenbaum,* 166 Pa Super 120 (1950); *People v. Gotham Book Mart,* 285 NY Supp. 563 (1936); *People v. Miller,* 297 NY Supp. 583 (1935); *People v. Viking Press,* 264 NY Supp. 534 (1933).

not pornographic but supposedly obscene is the general public. The former is almost certain to appeal to prurient interests. It is unlikely that the latter will do so. Therefore, it could be held, without abandoning any of the present positions of the Court except the average man doctrine, that only pornography had a substantive tendency to appeal to the prurient interests of its probable audience and thus it alone was subject to control.

There are several advantages in controlling pornographic rather than obscene matter. While there can be no iron clad definition of "pornographic," it is obviously easier to distinguish pornography from non-pornography than obscenity from non-obscenity. The practical tests suggested above[76] or a similar set would avoid the fine spun analysis which the courts must presently employ when attempting to weigh quantities and functions of obscene matter within a work against its general literary merit. The concept of psychic distance will provide the Court with a strong theoretical base if it feels the need of one. Moreover, it can be demonstrated that pornography has a much closer link with a real social evil than obscenity. The style, content, and manner of publication and sale of pornographic materials at least implicitly suggests that the thrill which is being sold is forbidden fruit. There is a certain recognition of present standards and a glorying in transgressing them. It is much easier to see a connection between this kind of thing and an evil which society has the right to control than between lustful thought and such an evil. Stress on the corruptive tendencies of pornography would shift the emphasis from regulation of thought to regulation of a social evil and would allow those legitimately espousing change in sexual standards, rather than perverse violation of existing ones, the same protection as other advocates of change.

Finally, a shift to the pornography standard would allow the Supreme Court to uphold state and federal legislation without unduly limiting freedom of expression. The legislatures and all but the lunatic fringe of the voters who elect them are not really concerned with whether a few thousand copies of *Lady Chatterley's Lover* are sold within their borders. Obscenity laws are intended to prevent the sale of masses of French post cards and

[76] See p. 28 above

ten pagers, not the purchase of collectors' editions of Aristophanes. The Court can honor all the dictates of judicial modesty before legislative command and, at the same time, protect the widest range of literary and scientific expression by holding that obscenity laws control only pornographic materials.

The adoption of a pornography standard would be another step in the movement of the courts to weaken the Hicklin rule. But in spite of the whole book, *Butler* and average man doctrines, the ghost of Chief Justice Cockburn still roams the judicial corridors. His chains may be heard rattling in the exclusion of obscenity from first amendment protection. As long as the courts continue to deal with obscenity as a matter of incitement to thought rather than action, they will remain in the grip of psychic phenomena. This is not to say that the courts can ever totally avoid the investigation of human thought but to insist that the recent decisions of the Supreme Court, by emphasizing libidinous thought as the evil to be controlled, have left the courts in much the same position as they were in 1868. We may expect that the Supreme Court will find the task it has set itself both difficult and tedious. The role of moral guardian to the thought of the community is not an easy one.[77]

[77] For extended and differing treatments of the moral role of the courts *cf.* Walter Berns, *Freedom, Virtue and the First Amendment* (Baton Rouge, 1957) with Edmond Cahn, *The Moral Decision* (Baltimore, 1955).

BRITAIN'S "GRAND DESIGN"

L. F. Percival, Jr.

SINCE World War II within the movement for European unity, Great Britain's role has been a crucial one. Many of the ideas leading to the unity movement have been suggested by British statesmen, notably Sir Winston Churchill. The attitudes of the different British governments toward specific organizational projects from the Brussels Treaty through the Council of Europe and OEEC to the European Coal and Steel Community and European Defense Community (EDC) and now the Free Trade Area have played a vital role, positively or negatively, in shaping the nature and institutional structure of these organizations. Some critics have argued that Britain's unwillingness to participate fully in EDC doomed that projected defense arrangement to failure since France needed Britain as a counterweight within the compact. Suspicions have been voiced that the United Kingdom tried to keep the ECSC from being formed and to prevent the Euratom and common market treaty communities from being established. It is not the purpose of this paper to debate or try to explain such a complex problem. Nor is it the purpose to adumbrate the reasons for British views toward these various institutions. Rather the purpose is to consider Selwyn Lloyd's "Grand Design" proposals to see if they illustrate any problems which arise between the United Kingdom and the six nations of "little Europe" in regard to the eventual goal of European unity. From an examination of these proposals and their reception on the continent so far, some light may be shed on the problems posed by the use of different approaches to the achievement of European unity.

In 1956, there were a variety of events and developments having a significant impact upon efforts toward European unity, which has been such an important goal of Western European governments since World War II. In May, 1955 at Messina the Foreign Ministers of France, the German Federal Republic, Italy and the three Benelux countries had formally launched a renewed drive toward further European integration which had been so abruptly stalled by the French National Assembly's

rejection of the European Defense Community Treaty the previous August. However, it was not until 1956 that detailed negotiations on the establishment of a common market and an atomic energy community among these six nations of "little Europe" were seriously underway. In the autumn of 1955, Monnet's Action Committee for a United States of Europe had been formed. By the spring of 1956 this group, which included most of the leading non-communist political and labor leaders in the six nations, had in full swing a program advocating these two new functional goals of integration. Indeed the Spaak Committee reports, designed to serve as the springboard for governmental negotiations among the six by setting forth basic objectives and possible means of achieving them, only became available that same spring. Furthermore, the year opened soon after the December victory of the pro-German parties in the Saar elections for a new legislature. This victory, following so swiftly upon the rejection of European status for the Saar in the October 1955 referendum, urgently posed the problem of a definitive settlement of the Saar issue between France and Germany. An amicable bi-lateral solution of this issue was an obvious *sine qua non* for the successful conclusion of any new integration treaties in which France and Germany would play key notes. It was to be faced on the French side by a new Socialist-led French government, the product of the national parliamentary elections in France near the end of the year caused by Edgar Faure's dissolution of the French National Assembly.

Both rancor and dismay existed still over EDC's defeat among its proponents within the six nations. But the poisoned atmosphere which existed over this issue was beginning to lighten, although it still divided some advocates of further European integration. The expanded Brussels Treaty Organization, the Western European Union, which had been devised as an alternative to EDC to facilitate West German rearmament, was in its organization infancy. Meanwhile, the so-called "Three Wise Men" of NATO were studying ways and means of improving its over-all strategic and political effectiveness in order to recommend measures which might be undertaken to improve the fashioning of common international political and military policies and actions among the treaty's member states. Within the

broad European movement, deepseated divisions, evident throughout the past decade, among integrationists and federalists, functionalists and advocates of immediate political union, and those who favored cooperation and intergovernmental action only, still persisted. In sum, it was a gray period, one of transition and stock taking. However, the shock of EDC's defeat was being dissipated. Negotiations were in hand for further functional and sector integration among the six, while France and Germany were seeking a solution to the Saar problem. By mid-summer, hope was in the air. It received a decided boost from M. Mollet's successful steering of the EURATOM concept through a clarification debate in the French National Assembly in July. This success suggested that the divisive effects of EDC's rejection might have been overcome and that France would not again be a stumbling block to further integration efforts.

Into this atmosphere, Nasser tossed his bombshell. Nationalization of the Suez Canal in August, 1956 directed most European diplomatic attention toward a resolution of this vital problem. But the closure of the canal had a tremendous impact on the European movement. The great dependence of Western Europe on Middle East oil as a source of energy became dramatically manifest, a fact which strengthened the argument of the proponents of EURATOM who saw it as providing a potential source of urgently needed energy for Western Europe's industrial economy. The economic interdependence of the Western European countries and the United Kingdom was forcefully brought home to them also. Moreover, the Franco-British Suez adventure and its aftermath exposed the weakness of the political bonds among the European countries. It inevitably seriously impaired the cohesiveness of the Atlantic Alliance. The economic consequences and the profound policy divergence within the Atlantic Alliance made the need for harmonizing policies and for greater political consultation among the NATO members patent. While action in this area had been initiated earlier, it received a shot in the arm from the Egyptian action and its tragic aftermath. The Suez problem and its consequences must have contributed to the sense of urgency which characterized the Mollet-Adenauer meeting of early November, 1956. General agreement on issues with regard to the common market, EURATOM and

the Saar problem were reached. Remaining details were turned over to experts for speedy resolution. It was then clear that some solution would be found for the only outstanding major common market problem then unresolved, the inclusion in or the association of the French overseas territories within it.

Within the OEEC, conversations had been proceeding for some time with regard to an atomic energy program among the member states. In the summer of 1956, Britain had proposed the possibility of a Free Trade Area in industrial goods among the OEEC countries in association with the six members who were then moving toward the goal of a common market treaty arrangement. Progress among the six in these areas seemed to speed up OEEC consideration of these projects a bit, but it appeared that the principal governmental figures and negotiators of the six were primarily devoting their attention to activities within this framework rather than within the OEEC. In the autumn, however, OEEC under British leadership and with American aid marshalled its facilities for the establishment of an emergency oil committee to make up the continental petroleum product deficiencies caused by closure of the Suez Canal. As a result of these various factors, OEEC consideration of atomic energy and FTA matters seem to have moved rather slowly toward the end of 1956.

When the NATO Ministers met in Paris in December, 1956, the need for strengthening the fabric of the NATO alliance was quite universally accepted. In both Britain and France, there was deeply held dissatisfaction over both the nature and conduct of American policy during the Suez Canal crisis and subsequent US-led United Nations condemnation of the Franco-British occupation of the Canal Zone. Italy and Western Germany, however, had assumed a coolly distant posture with regard to the Franco-British action which backfired and split the NATO alliance. At this meeting, the "wise men" offered their report on ways and means of strengthening the alliance, which was the principal subject of discussion apart from defense and military considerations. Among the NATO nations, general agreement, albeit with some differences of emphasis, was reached on the necessity for more extensive and thorough political consultation and coordination and common shaping of external policies.

Agreement on machinery for more effective political consultation was achieved.

It was within this general context that Britain's Foreign Minister Selwyn Lloyd launched his proposal at the NATO meeting for the development of more extensive Atlantic and European solidarity, known as the "Grand Design." Reports on the NATO meeting offered no specific text of the British proposals which were said to include a suggestion for the development of one over-all parliamentary Assembly for the Atlantic Community. The keystone was said to be an effort for greater Atlantic Community and European cohesiveness and drawing together. The proposal tended to be overlooked in the press reports of the NATO meeting though it soon became the subject of editorial comment in various news media. Some comment contrasted the proposed assembly with Italian Foreign Minister Martino's suggestion at the earlier WEU meeting in Paris that the WEU parliamentary assembly be directly elected by universal suffrage in the seven nations adhering to this treaty organization. Paul-Henri Spaak, newly elected Secretary-General of NATO and an architect of European unity reportedly threw "cold water" on the idea of an Atlantic Assembly suggested by Mr. Lloyd. He was reported to have remarked that there were already several European Assemblies making up a patchwork that "somewhat lacks beauty."[1]

While British initiative in endeavoring to strengthen the Atlantic community was generally applauded, press comment tended to extensive speculation on what was comprehended in the British suggestion. Hope was expressed that concrete proposals would be presented for consideration. There appeared to be considerable agreement that the proliferation of European institutions and assemblies associated with the Council of Europe, the European Coal and Steel Community, WEU, and the new communities, was an unfortunate development which called for remedial action. The British press saw an opportunity for British leadership in developing common European action but there was some trenchant comment on the initiative itself. For example, *The Economist* recognized that the situation of the time most seriously posed the problem of establishing a "sus-

[1] *New York Times*, December 16, 1956, p. 22.

tained common will for European action" and argued Britain should take the lead in shaping it. It asked: "What would happen should American interest one day diverge from that of the rest of NATO? It may have been a sense of this, as well as an unwillingness to be sold on Signore Martino's plan for an elected WEU Assembly, which prompted Mr. Selwyn Lloyd to formulate his rather wooly "grand design" of a "strong European community" functioning within the Atlantic Community and to envisage "one Atlantic Assembly."[2]

On February 7, 1957, the British government issued a White Paper on the Free Trade Area, setting forth the principles upon which the United Kingdom government based its proposal and emphasizing the problems posed in its associating with the common market due to Commonwealth ties and the need for confining the FTA to industrial products. One day later, the House of Commons debated the Council of Europe and Western European Union. This was the first debate held on the Council of Europe since 1953. Directed to the question of the effectiveness of the Council and the WEU in fulfilling their objectives and to the role of the assemblies in these organizations, the debate was expected to provide an occasion for an official and formal discussion of the "Grand Design." Though an occasional speaker made some reference to it, it was not officially described. Most speakers acknowledged that some work being done in the Council and the WEU was useful, but there was a general consensus among the speakers on the imperative need for more action on the part of these institutions. Speakers from both Labor and Conservative benches saw the need for greater European cooperation and unity of direction. Governments and the Council of Ministers of both institutions came in for considerable criticism on the grounds of lacking leadership and being unresponsive to the Assemblies' demands and wishes. Although theoretically confined to discussion of a motion on the matter of European parliamentary effectiveness in working out European policies, some speakers, nevertheless, tended to emphasize their belief in the need for broader parliamentary representation in the Atlantic community. Generally, however, there was a clear line of distinction drawn between the European and Atlantic

[2] *The Economist,* December 22, 1956, p. 1058.

communities. The Council of Europe was severely criticized as a "talking club." But the real direction of criticism was on the subject of the proliferation of European Assemblies, the inconvenience of Strasbourg as a meeting place, the lack of adequate administrative facilities for the WEU Assembly meetings, and the absence of effective parliamentary relations with the OEEC. The debate was characterized by appeals for cooperation, intergovernmental action, and more effective ministerial leadership. It disclosed no strong desire for federative relationships on the continent. On the contrary, the points at issue appeared more mundane and not within the realm of what might be called high policy.

The government's views were presented by Minister of State Ormsby-Gore when he intervened in the debate. Referring to the Selwyn Lloyd proposals in the December NATO meeting, he stated: "Broadly speaking, that (speech) set out the objectives we hope to obtain. It would be a pity to read into those remarks the idea that those final objectives were immediately in front of us, but nevertheless these are the objectives at which we aim."[3] He expressed the conviction that the European community must develop within the Atlantic Community and that there must be no mutual exclusiveness. Reviewing the various assemblies in existence, the Common Assembly of the Coal and Steel Community, the Consultative Assembly of the Council of Europe, the WEU Assembly, and the NATO Parliamentary Conference, he argued that there would be a great common success if these assemblies fulfilled one function which Mr. Harold MacMillan had described at Strasbourg in July, 1955 as "the Assembly shall primarily regard itself as a great convention of Private Members, a Parliamentary forum for free and uninhibited discussion to review great questions." In his view, the assemblies should fulfill the functions of: (1) bringing the activities of their respective organizations to the attention of people at home, and (2) exposing these intergovernmental organizations to constructive parliamentary criticism. Expressing doubt that assemblies should have "executive functions" and general dubiousness with regard to "written constitutions," he thought that the 1952 Eden proposals might have led to more effective Euro-

[3] Hansard #379, Col. 845-854.

pean organizations by bringing the assemblies together. He asserted "one way of arranging matters might be to have the work of the assembly divided on a functional basis between committees or commissions rather along the lines the Honorable Member (Sir Robt. Boothby) suggested." Defense matters would be debated in a defense committee. Those countries not members of NATO would presumably not wish to be represented on that committee. Such organization of work in committees he described as similar to the organization within the United Nations. Noting that there might be some difficulty with the ECSC in this context, he opined nevertheless that the objective should be "one grand assembly" getting public attention. Instead of a constitution, he expressed a strong preference for "flexible arrangements." The "Grand Design" as such was not mentioned but he asserted that the government's position in the matter was under study. Surely some of the thoughts expressed in his intervention represented what was then current governmental thinking on this subject.

References to the "Grand Design" thereafter appeared occasionally in various news media. Also it seems clear that the British ideas were the subject of exploratory diplomatic conversations and discussion among governments during the spring of 1956. Shortly before the opening of the 9th session of the Council of Europe in late April, however, it was publicly announced that the United Kingdom government would present its "Grand Design" proposals to this body. The British position was to be presented by Minister of State Ormsby-Gore since Foreign Minister Selwyn Lloyd was to represent the United Kingdom at the NATO Ministers meeting being held at Bonn during the same period. When the Council of Europe opened on April 20, 1957, President Ferdinand Dehousse warmly greeted the British initiative. He welcomed the "Grand Design" proposals as disclosing Britain's continued interest in Europe, as did her suggestions for a Free Trade Area in association with the common market.

The Constituent Assembly had awaited Mr. Ormsby-Gore's statement with interest and attentiveness. This was to be the unveiling of the "Grand Design" which heretofore had been expressed in most general terms. The substance of the design had seemed rather insubstantial and ambiguous before. Conse-

quently the official presentation was eagerly awaited as it was expected to define a new United Kingdom position on its role in the development of European unity. Moreover, the six were then on the threshold of entering upon their two new communities on January 1, 1958. The vital role which Britain could play in furthering cohesion and unity within the European community was fully recognized. This authoritative statement therefore was regarded of major import.

In the political debate on May 1, 1957, Mr. Ormsby-Gore presented the British proposals in their first formal public exposition.[4] Assuring the assembly that the recent British decision to withdraw troops from the continent had been made with full allied consultation and should not be considered as a British retreat from the continent, he asserted that in his government's view "European cooperation" rested on three main elements: (1) the six power community; (2) the broader community of the Council of Europe and OEEC; and (3) the Atlantic Community in which the European community should develop as an equal partner. He saw NATO as providing the higher political and strategic direction for the broad community within which WEU should be a "core of unity." In the economic area, OEEC was the best and chosen instrument. It should not swallow up the six but be the framework within which the rest could associate with the six. Admitting that the Assembly (presumably the EEC and Euratom ones too) of the six had "executive" powers giving it (or them) a different character, the United Kingdom had nevertheless put forward new proposals for an assembly common to all the European institutions. The "Grand Design" should be primarily considered a proposal for the sharing of administrative facilities among the various assemblies. The new assembly, he suggested, should be for all the "intergovernmental" bodies with commissions for political, economic, social and cultural, legal and administrative, and defense problems. There should be a common meeting place and one secretariat (perhaps with defense apart). Arrangements between the various organizations and their respective assemblies should be on an *ad hoc* basis except for an annual report by the institution to the assembly. He added that the proposal was "not

[4] Council of Europe News, Special Issue, May 1957, p. 10.

cut and dried and was open to suggestion" and that it would be desirable to get Canadian and American parliamentarians involved in the over-all assembly's activities to the maximum possible extent. The aims of the proposal were threefold: (1) to bring both European and Atlantic organizations to public attention; (2) to expose intergovernmental activities to parliamentary criticism; and (3) to stimulate governments' vigilance in defending the Western Alliance. "What we want," he said, "is to give greater impact to parliamentary association in Europe bearing in mind that the majority of governments are not prepared to give executive powers to any assembly of parliamentarians for Europe." He went on to state that the UK wished to participate in a Free Trade Area but could not be asked the too high price of sacrificing Commonwealth ties. He gave assurance that in the field of atomic energy Britain stood ready to help the Euratom community and would participate in the OEEC nuclear energy group. The UK wanted wider political and military consultation and "this was the reason for Mr. Lloyd's 'Grand Design' which was not simply a proposal for one single assembly but embraced all aspects of western cooperation." The proposal had been both misinterpreted and misunderstood but surely "order" was required to give maximum effectiveness to the organization of the West.

What had Mr. Ormsby-Gore said really? A comparison of his official presentation of the "Grand Design" with his less formal intervention in the February 8, 1957 House of Commons debate discloses a remarkable similarity of ideas.[5] It suggests that, in the ensuing months of study, thinking within the British government had not greatly changed on the substance of the "Grand Design." True, the formal proposal divided the main communities into three instead of two as he had done earlier. The Atlantic community was seen as the larger and broader community within which the European community should develop as an essential part, but recognition was given to the narrower community of the six nations of "little Europe" within the broader European community. The view that the assemblies should have no "executive" functions, by which is meant no legislative or other powers, is common to both statements. The

[5] Hansard #379, Col. 845-854. See also above p. 46.

asserted objectives of the suggested single assembly are: (1) to acquaint the public at home with the activities of the various European organizations, something of a public relations and educational function; (2) to subject the institutions to parliamentary criticism; and (3) to stimulate governments' vigilance in defending the western alliance, an objective not stated but implied in his earlier speech. There remained the same emphasis on cooperative, consultative, and intergovernmental effort with the European community, all of which had been the hallmarks of the approach of British governments to European unification problems since World War II. Unwillingness to give any power to a parliamentary assembly was specifically asserted. How such a parliament could in any practical fashion expose intergovernmental activities to effective parliamentary criticism under such circumstances was never explained. Inherently, there was a contradiction in the statement itself which first asserted that the primary purpose was to share administrative facilities among the assemblies while it ended on the high note that the "Grand Design" was not so restricted but embraced all efforts at Western cooperation to facilitate wider political and military consultation. Reduced to its practical aspects upon which action could theoretically be taken, the proposal was that there should be one common assembly with which the activities of the Consultative Assembly, the Common Assembly of the EESC and presumably the EEC and Euratom Assembly (which would have legislative powers) should be included. This large common assembly should have commissions for the various questions which would come before it as he had described on February 8, 1957. In addition, it was proposed that there should be a common meeting place and a common secretariat, but it still seemed possible that there should be a separate commission set apart for defense matters. How this commission could be a part of the over-all assembly and still not part of it remained unclear. No attempt was made to clarify this anomaly. Perhaps the key appeared in the appeal to "order" to give maximum effectiveness to the organization of Western Europe. If this was the heart of the proposal, and behind the extensive verbalizing it appeared to be, the natural question arose whether the design might not be better qualified by a somewhat less grandiloquent adjective than "Grand."

Nevertheless, there were some fundamental aspects of the proposal which merited closer attention. In proposing rationalization of European institutions, the suggestion was certainly directed toward an objective which had become a major concern of all advocates of European unity. Divisions on means for rationalizing institutions, however, followed the lines of other divisions, that is, among the six and the remaining members of the Council of Europe and the OEEC.

Before considering the impact of this proposal and its ramifications, it might be well to compare it with the Eden proposal to the Council of Europe in 1952. Mr. Ormsby-Gore had mentioned this in his February 7, 1957 Commons address, but omitted reference to it in his formal presentation of British views on May 1, 1957. What were the Eden proposals, in what context were they made, and is there any valid comparison between them and the "Grand Design" of six years later?

The Eden proposals had been made to the Council of Ministers of the Council of Europe in March 1952. There are certain parallels with the European political situation then and in 1957. In 1952, when the Consultative Assembly met on May 26, four countries had already ratified the European Coal and Steel Community Treaty and the other two were about to do so. The Bonn Conventions, granting sovereignty to the German Federal Republic were signed by the United States, the United Kingdom, and France that same day while on the morrow the European Defense Community Treaty was to be signed. Not only was West German sovereignty being restored, but the "six" were embarking upon the road to closer integration. In fact, "The 'little Europe' of six powers was in the ascendant."[6] The Eden ideas were proffered in a similar political climate to that of the spring of 1957 when it had become quite certain that the six would go ahead with the common market and Euratom barring unforeseen developments.

The Eden proposals were embodied in an aide memoire sent to the Committee of Ministers in March which read in its principle operative passages as follows:

The movement for unity in Europe, which led to the creation of the Council of Europe, is now flowing along two main streams; the

[6] ***The Council of Europe*, A. H. Robertson, p. 98.**

Atlantic Community, a wide association of states which, without formal surrender of sovereignty, is achieving unity of purpose and action through the machinery of the North Atlantic Treaty Organization, and the European Community, a small group of States which is moving towards political federation by the progressive establishment of organizations exercising supranational powers in limited fields. The Council of Europe seems to be in danger of becoming stranded between these two streams.

In an attempt to acquire "limited authority but real powers" the Assembly has produced a draft new Statute of the Council of Europe, which will be on the agenda at the next session of the Committee of Ministers. This transforms what is now a purely consultative body into a quasi-federal institution with legislative and executive powers and the right to be consulted by Member Governments on certain matters within its competence. If the new Statute were adopted this would undoubtedly make things very difficult for the United Kingdom.

In Mr. Eden's view, a more promising future for the Council of Europe would be in a remodelling of the organization so that its organs could serve as the institutions of the European Coal and Steel Community, the European Defence Community and any future organizations of the same structure and membership. The advantages would be:

a) The Council of Europe would be given valuable work to do;
b) The duplication of European bodies would be avoided;
c) The European Coal and Steel Community and the European Defence Community would be provided with ready made machinery.

Mr. Eden is confident that a satisfactory "two-ties" system could be evolved which would enable the Council of Europe to continue its work as an organization for intergovernmental cooperation in Western Europe. On occasions the Committee of Ministers and the Assembly could meet on a six power basis to transact business connected with the Coal and Steel Community, the Defence Community and any future organizations of the same type and membership. At the same time both the Committee of Ministers and the Assembly would continue to meet on a 15 power basis as at present for the purposes defined in Article 1 of the Statute. In particular, the present practice of receiving and discussing reports from the OEEC should be maintained. The full Council would also discuss questions

relating to the European community which were of general interest to Western Europe.[7]

This analysis also divided the European unity movement into three streams; Atlantic community, the tighter community of six, and the broader community of states within the Council of Europe. It opposed the proposals made for a change in the Statute of the Council of Europe which would have given the Consultative Assembly some real powers. Instead it suggested the latter be reorganized so as to serve the ECSC and EDC and any such future organizations among the six. It was argued such a procedure would give the assembly valuable work to do and provide the six with ready made facilities for their new organizations. In speaking of his proposals in September, Sir Anthony mentioned the possibility of establishing commissions for specialized subjects. In effect, a close examination of the substance of these and the Ormsby-Gore proposals six years later show that they are just about the same in spirit though there may be some changes of language here and there. Common to them is unwillingness to give assemblies any real power, a desire for intergovernmental cooperative arrangements instead of supranational functional agreements, but at the same time a wish to include the integrated communities having federal features within a common over-all assembly having common administrative facilities on the grounds of more effective and efficient organization.

The Eden proposals were found largely unacceptable although they may have contributed to the eventual decision within the Council of Europe and the Coal and Steel Community to establish "organic links" between these two organizations, these "links" essentially being provided by reports from the CSC High Authority to the Council of Europe and by an admonitory protocol to the CSC treaty urging nations to appoint the same people to the CSC Common Assembly and the Consultative Assembly. Under British leadership unsuccessful efforts were made to have observers from the Council of Europe sit in both the Common Assembly and the CSC Council of Ministers. These proposals had generated some suspicion among the six that the

[7] *The Council of Europe*, A. H. Robertson, p. 99.

British objective was to try to enjoy the privileges of participating in the policy making of the Coal and Steel Community without being burdened with the full responsibilities of membership. British motives were assayed somewhat cynically perhaps. The "links" which were developed were straightforward and avoided the confusion of lines of authority and responsibility which might otherwise have resulted. The Eden proposals just did not really recognize the vast difference in the nature of the Council of Europe and the new integrated community on federal lines. They showed no substantial appreciation of the difficulties which might be engendered by such suggested procedures. Whether or not intended to slight or gloss over the federalizing tendency manifest among the six, they did in fact tend to pass over it and to assert an essentially United Kingdom viewpoint seemingly devoid of a recognition of the realities extant among the six. Therefore, the suspicion arose that British intentions were to try to exercise some form of control over the six. In all justice, it may well be that the proposals naively disclosed no real understanding of the fundamental federalizing current among the six. If on the other hand, they were as subtle as analyzed in some quarters, they were self-defeating.

It was against this background that Mr. Ormsby-Gore's proposals, which had a familiar ring, were presented to the Consultative Assembly. The Political Committee reported out its belief that it was premature to take any position on the "Grand Design" which was then subject to discussion by governments. It recommended that the Assembly be consulted before any final decisions by the Committee of Ministers in the matter were taken. A sub-committee was appointed to study proposals for the rationalization of European institutions including the assemblies. This general matter was universally regarded as urgent since the Rome treaties would soon go into effect among the six. The sub-committee was, *inter alia*, to consider these British proposals as well as the so-called Martino proposals which the Italian Foreign Minister had presented to the Committee of Ministers during the then current session of the Council. These latter proposals apparently were not formally presented to the Consultative Assembly. They were reported, however, to be based on the principle of maintaining separate Assemblies for the

Council of Europe, WEU, and the community of six and to have included the idea, advanced by Martino at the December 1955 meeting of the WEU Council of Ministers, of electing members of the WEU parliamentary assembly by universal suffrage.

Addressing the Assembly on behalf of the Committee of Ministers, Foreign Minister Luns of the Netherlands had earlier stated that while WEU had under consideration the rationalization of European institutions, it was generally agreed that no fourth assembly should be created. There was, however, the problem of linking the six with the seven, i.e. the UK and the six of "little Europe" in WEU. He said there were two schools of thought on this matter. The first held that the existing assemblies should preserve their identities while harmonizing their activities. The second thought to replace the assemblies by specialized commissions. Common to both was the desire for a single seat, for joint administrative services, and for considerable autonomy. But there were differences since the first would preserve the powers, rights, and duties, laid down by treaty while the second really sought to abandon the principle of attaching parliamentary assemblies to each European institution. There was agreement that something should be done. When the WEU[8] had decided, the Council of Europe would be consulted. In closing the Assembly, President Dehousse also asserted that rationalization of institutions certainly deserved special mention, including the "Grand Design" proposals. His statement, however, gave some measure of the reception of the British proposals when he said that while there was unanimity on the need for regrouping institutions, the distance between the various theses advanced remained considerable. A compromise was necessary. In any case, the United Kingdom deserved tribute for the step it had taken.

When the WEU parliamentary assembly met at Strasbourg right after the Council of Europe, the "Grand Design" again was raised. As Chairman of the Council of Ministers, Paul-Henri Spaak spoke on the need for rationalization while noting that WEU was studying the matter in the Council of Ministers, he said the ideas of the assembly on the subject would be welcomed since it was best suited to advance proposals along these lines. A

[8] *Council of Europe News*, Special Issue, May 1957, p. 3.

resolution adopted recommended that the Council of Ministers consult the Assembly on its views of both the Italian and British proposals before taking any decision.[9] It was further decided that the General Affairs Committee of this organization should prepare a report on the subject for presentation to the autumn session of the Assembly.

The annual Congress of the European Movement was held at Rome from June 10-13, 1957. Here again, the "Grand Design" and the general problem of rationalizing European institutions was a major issue since the new treaties among the six had been signed and were practically through the ratification process. Echoes of the Luns and Dehousse statements mentioned above were contained in the Congress' final resolution. Section A of the resolution appealed to the United Kingdom and the other nine countries of the Council of Europe to agree to make headway on the rationalization of the organization of the fifteen by combining the OEEC and the Council of Europe.[10] Section B of the resolution read: "While welcoming the Selwyn Lloyd plan as a sign of the United Kingdom's growing interest in Europe, the Congress cannot approve any scheme which fails to recognize the right of Europe to have a common policy of its own and might result in depriving the European institutions of their distinctive powers. The European Community is one thing; the Atlantic Community is another." The resolution reaffirmed European loyalty to NATO but asserted the importance "to preserve the autonomy of Europe as a political concept and a juridical system."[11]

In September the Political Committee of the Council of Europe met to consider the business coming before its autumn session. Among the items discussed was a draft resolution regarding rationalization of institutions, a provision of which reportedly was that the assemblies of the various institutions might have to be kept separate although there could well be liaison arrangements such as had existed between the Council and the ECSC. When the Consultative Assembly met in October, the Political Committee formally reported its belief that after having ex-

[9] *Council of Europe News*, June 1957, p. 6.
[10] This would require bringing both Portugal and Switzerland into the new organization since they are now only members of OEEC.
[11] *Council of Europe News*, July 1957, p. 8.

amined the British proposals, i.e. the "Grand Design," it believed that it would be possible only to reduce the assemblies to three: the Consultative Assembly of the Council of Europe; the WEU Assembly; and the new common assembly of ESCS, EEC, and Euratom.[12] Thus, it would appear that the Martino proposals had found more favor with this committee.

In the meantime, the House of Commons had debated the WEU on August 2, 1957. In the course of this debate, Mr. Ian Harvey, Under-Secretary of Foreign Affairs, had announced that the Council of Ministers of the WEU were seized with the "Grand Design" proposals. He stated

> Reference has been made to the Grand Design. . . . As a result of the initiative taken in this matter . . . other countries have reacted and brought forward their proposals. I do not think that anyone in the house, no matter how partisan he may be, would suggest that it is for this country to impose on the European scene a solution which everyone ought to accept . . . nor would there be much hope of them doing so. If as a result of introducing the ideas from the "Grand Design," a reaction has been obtained from other countries and the recognition that the present position is not entirely satisfactory, some considerable progress has been made.
>
> As the members know, we (the WEU Council of Ministers) shall be meeting before very long. We shall persevere with the ideas in line with the "Grand Design" which, if I may say so, have found expression in the debate today, namely, a desire for a new form of expression, the elimination of frustrations which are at present inherent in the system, and a more comprehensive organization of all the various assemblies which exist in Europe today.[13]

When the WEU Assembly met in October, 1957, the rationalization of institutions was again a major subject on the agenda. In opening the session, its President, Sir James Hutchinson, British Conservative, stated that the situation existing was clearly unsatisfactory because of the risks of duplication and the frictions in competence of the various assemblies. "Whether it be called the 'Grand Design' or by some less ambitious name, it is clear that some action is urgently needed. The Treaties of Rome, the possibility of a Free Trade Area and the future of NATO

[12] *Council of Europe News,* Special Issue, November 1957, p. 6.
[13] Hansard #400, Cols. 1701-1704, August 2, 1957.

all demand some new conception," he said.[14] In presenting the report of the General Affairs Committee, Van der Goes van Naters somewhat sarcastically noted that the "European Wisemen" had solved the WEU problem of association of the seven nations by dismissing it.[15] Nevertheless, the subject was of primary importance to the WEU since Mr. Lloyd had submitted his "Grand Design" to this organization. He proposed to tackle the problem essentially in terms of three considerations: (1) how to give assemblies more effective control over the executive organizations to which they were attached; (2) how to avoid confusion between the European and Atlantic Communities and (3) how to define the "organic relation" between the six and the United Kingdom. From his report and the deliberations of the WEU Assembly there stemmed a recommendation approving the ultimate aim of rationalizing the institutions. It expressed the view that any proposal for the creation of an Atlantic Assembly, before European unification was achieved, should be cautiously approached. Considering the relationship of the United Kingdom to the EEC, Euratom, and the ECSC to be "most urgent," as well as that the rationalization of the assemblies should be accompanied by a rationalization of the relations between assemblies and their respective executive and ministerial bodies, it recommended: (1) that Ministers be required to present reports which should be subject to assembly rejection; (2) that recommendations of European assemblies be considered in national parliaments in order that Ministers might be instructed by their home parliaments to carry out these recommendations; (3) that extensive financial autonomy be extended to the assemblies; and (4) that the assemblies have more technical research experts available in order to reduce the number of texts appearing before the Assembly for consideration.[16] The latter two points might be considered of relatively less importance than the first two. They all, however, indicate the continued parliamentary effort to get some measure of control *vis à vis* the executive, which the "Grand Design" proposals, in the form in which presented were obviously designed to avoid. Furthermore, the reso-

[14] *Council of Europe News*, November 1957, p. 6.
[15] See p. 57.
[16] *Council of Europe News*, Special Issue, November 1957, p. 6.

lution was so designed as to put pressure upon the United Kingdom to change its relationship with the six, especially in its rejection of the Atlantic Community Assembly concept as being premature and in its suggestion that the implementation of any such idea should await the rationalization of the European Community. Such pressure as the Assembly might be able to develop was in the direction of modifying British proposals in the direction of making them more amenable to the six and of establishing some sort of parliamentary responsibility on the part of the executive, which runs contrary to the Lloyd ideas which seek to maintain the assemblies as consultative, i.e. legally powerless bodies.

The WEU Assembly session was followed by a meeting of the Council of Europe. As rapporteur of the sub-committee of the Political Affairs Committee, Mr. Karl Mommer asserted that after examination of the British proposals, the committee had concluded that it would be impossible to reduce the assemblies to less than three. In other words, the Italian proposals offered by Mr. Martino, in principle at any rate, gained the approval of the committee. Mommer saw the problem as being one of efficiency and the economy of time and money. The specific Italian proposal to send the same members to all three assemblies did not appear feasible, but partial membership with an adequate system of substitutes did seem feasible and desirable. As for the participation of Canadian and American parliamentarians, the 1951 Strasbourg Conference had been successful and seemed to offer the best example of future efforts in the area of common parliamentary meetings. The sub-committee merely recommended that reports of the new communities' assembly be forwarded to the Council of Europe and that common sittings be held when urgently required; in other words, the same system as had prevailed between the Council of Europe and the ECSC. Various recommendations and orders were passed in this session pertaining to this general subject, the meat of which suggested: a common location for all institutions; that the OEEC and the Council of Europe be amalgamated at the earliest possible date without awaiting the outcome of the FTA negotiations; and that the Bureau of the Constituent Assembly arrange a meeting with the WEU and the assembly of the 6 in order that the

three assemblies could make recommendations to the WEU Council of Ministers about what should be done. This procedure was proffered since the Committee of Ministers had earlier undertaken to consult the Constituent Assembly on what should be done with regard to rationalization before taking definitive action.

The end of November, 1957 saw the second meeting of the "European Wise men" who had earlier met in Paris in September. This group under the leadership of Jean Monnet and Lord Layton, to which Van der Goes van Naters had earlier referred,[17] had made no definitive recommendations after its earlier meeting. After the second meeting it did make a number of recommendations. The pertinent ones in our context were that institutions should be concentrated in the same location with the possible exception of the WEU, that measures should be adopted to assure the greatest identity of membership in the various assemblies, and that the Council of Europe and OEEC should be amalgamated.[18]

When the Council of Europe Ministers Committee met on December 13 and 14 in Paris, they adopted a resolution to consider amalgamation of the Council of Europe and the OEEC after the Free Trade Area had been established. Thus, this decision ran counter to the recommendation of the Constituent Assembly.[19] Their resolution read in part that the Committee of Ministers decided "to examine at an appropriate moment, in the light of the establishment of, on the one hand of the EEC and Euratom, and on the other, the FTA, the advisability of certain measures of rationalization in the general framework of European collaboration.[20] It was to this resolution that Mr. Lloyd referred in the parliamentary foreign affairs debate of December 20, 1957 following his return from the Council of Europe, WEU, and NATO Ministers meeting at Paris when he said "I put forward a resolution on behalf of the United Kingdom government with regard to the rationalization of European organizations which was accepted by the Ministers."[21] So at the

[17] See p. 58 above.
[18] *Council of Europe News,* December 1957, p. 3.
[19] See above, p. 59.
[20] *Council of Europe News,* January 1958, p. 4.
[21] Hansard #408, December 20, 1957, Col. 739.

ministers level the issue of rationalization of institutions, which is essentially what the "Grand Design" is about, was again deferred. In the Council of Europe meeting of January, 1958 the representative of the Ministers, Commerce Minister Skoug of Norway, when sharply questioned on this problem since the assembly had earlier recommended the swiftest amalgamation of the two institutions replied that the Ministers had been reluctant to take a "definite" resolution since the six had not held their important meetings of December 9 and January 7 on the OEEC matter. He explained, however, that the creation of a free trade area would make necessary a change in institutional structure. Consequently it had been deemed best to wait before taking a definitive step. The implication was clear that progress on the free trade area was a condition of rationalization of institutions at that stage, but the free trade area discussions were not progressing very rapidly then or apparently now. In fact, some estimates are that it may not see the light of day until two or three years from the present. It was, however, being used as a lever in the whole problem of institutional reorganization.[22]

There is, of course, another problem which plays an important role with respect to institutional change and modification of relationships between and among the various European organizations. This is the matter of the location of the new institutions of the six, an issue which has apparently not yet been resolved. While agreement is apparently general on the desirability of only one location, the place remains wide open. Various national aspirations enter into this complex problem. Luxembourg would like to have the institutions there, which is probably not possible on grounds of adequate facilities. Failing this, however, it would like to retain the ECSC institutions. In fact, M. Bech recently resigned as Prime Minister to devote his attention to defending Luxembourg interests in this matter as Foreign Minister. Italy would like some institutions within her borders. Belgium would like to see Brussels as the site, while Paris has much to recommend it on grounds of a central location in which other organizations are already located such as OEEC and NATO. Here French governments have something of a problem because of Alsatian pressures that Strasbourg remain the capital of

[22] *Council of Europe News*, February 1958, p. 2.

Europe. So there remains a fluid situation with regard to the location of these institutions. In the meantime, the first sitting of the new assembly of the EEC, ECSC, and Euratom met in March at Strasbourg and used the facilities of the Council of Europe as the ECSC had done in the past. This essential problem of location remains unresolved. It too will naturally have its effect on the rationalization proposals for European institutions which may well be considerably delayed in their final resolution if the coming into being of the Free Trade Area is to remain a condition for an overall re-grouping and re-organization.

The question of the "Grand Design" remains, however, unless it is to be considered merely to have been a tactical move on the part of the United Kingdom government executed for its psychological effect at a given time. It might be argued that the proposal was vague and insubstantial initially largely because it was offered in late 1957 without adequate consideration merely to make a gesture toward unity. It could have been seen as an effort to assert leadership and give some further substance to the concept of European unity after the shattering events of the latter part of 1957 which had so severely shaken the NATO alliance and the European community. In this sense, it would be interpreted as a psychological move to restore a sense of unity as well as an admonition to the smaller European community of six which was proceeding upon the road to closer integration to eschew the building of a bloc on the continent which might become closed and have aspects of a third force concept. Therefore, it could be argued that the British made an effort to maintain the bridge between Europe and North America in order to emphasize that the European community of fifteen or of six could only fruitfully develop really as part of the Atlantic community and not merely be confined to the six or some organization providing ties linking the six and the United Kingdom.

It is difficult to believe, however, that the "Grand Design" proposal was merely a tactical effort designed either to reassert British leadership or to show British interest in European unity after the difficult times caused by Suez and its aftermath. It will be observed from a cursory examination and comparison of the Eden proposals and the formal British proposals put forward by

Mr. Ormsby-Gore that the "Grand Design" concepts have been fundamental to British governmental thinking on the subject of European unity for some time. Furthermore, in their essentials, they reflect the thinking which went into the Statute of the Council of Europe and into the formation of such organizations as OEEC and NATO. They stem from the British view of the role of the United Kingdom as the center of the English Commonwealth and as the bridge between Europe and the United States. They reflect in the broadest sense the British analysis of the power position of the United Kingdom as the major European nation with world ties which is in a special relationship to both the United States and the continental powers of Europe. Thus, it is clear that the British proposals logically envisage NATO as the principal buckler of Europe against Soviet aggression and the European community as developing within the protective cover provided by this unprecedented league of national states in pooling their defense efforts into a coordinated force in defense of world and European security against Soviet aggression upon the European continent which remains one of the major power centers as well as the home of a common western culture. NATO is therefore seen as the overall strategic body, politically and militarily, while the OEEC, which accomplished so much in helping to restore the economies of Europe as a clearing house of American aid and later as a forum in which to seek liberalization of trade through the reduction of quantitative restrictions, is envisioned as the principle broad European organization for economic cooperation. These conceptions are quite clearly fundamental in the British attitudes of 1957 as well as of 1952.

At the same time, there are other fundamental positions which affect British views toward European unity. One is clearly a preference for inter-governmental organizations of a cooperative nature to accomplish European objectives. There is a basic sense of doubt about merging Britain and British institutions with any institution on the continent having powers of decision of a supranational character as well as doubts about the efficacy of written constitutions and federal arrangements in this situation. There is complete unwillingness to grant any "executive or legislative" powers to any European institution in

which the United Kingdom might participate and a clear preference for leagues or associations of states to deal with common problems on an *ad hoc* basis. In sum, the British position has been based upon an analysis of the United Kingdom's interests as a member of the Commonwealth and a major world power having extensive extra-European interests which regards more extensive participation in European affairs as essential in fostering a sense of Western European unity, but which still wishes to avoid merging some part of British sovereignty in a European organization. The position is based upon an appraisal of fundamental British national interests as well as broader Atlantic Community and Commonwealth security interests and shows a pragmatic approach to world problems not un-typical of past British attitudes toward international organization. It is difficult to escape the conclusion that the United Kingdom regards the Council of Europe as a league something like the League of Nations with a parliamentary adjunct, the principal purpose of which should be to enlighten its members' home constituents at home with the need for European cooperation at this stage in the world's history.

These attitudes and considerations which are clearly decisive in the British proposals become even more pronounced when their practical aspects are examined. The "Grand Design" proposals are quite specific with regard to the overall organization of a single European parliamentary assembly. This assembly, it is suggested, should have separate commissions for various fields of interest, including defense. In this last case, there is some thought that this commission might be "set apart." Within this overall assembly, all the fifteen of the Council of Europe would be represented. It would be located in one place and be serviced by a common secretariat. The commissions would be separate on a functional basis. As Mr. Ormsby-Gore said on February 8, 1957, they would operate something like the committees of the United Nations. These ideas are at the heart of the "Grand Design" and their principal appeal is in terms of "tidying up." Sympathetic response to the idea of rationalizing the institutions of the various European organizations has been general since everyone connected with these organizations has been perturbed at their overlapping functions, diverse administrative facilities, and

different places of meeting which have created many problems for the parliamentarians and ministers participating in their various bodies.

If, however, there has been general sympathy with the concept of achieving more rational organization, there has by no means been general acceptance of the British ideas which have been offered as the deliberations of the various European bodies mentioned above shows. Stated simply, this is because the institutions and purposes of the communities of the six are not compatible with the British proposals. British unwillingness to become involved in supranational institutions has been clear in all European discussion since World War II. It was highlighted by Britain's unwillingness to participate in either the ECSC or the EDC. This position has been accepted, albeit reluctantly, by the nations of the six, but the United Kingdom has unfortunately given the impression, at least in their formative period, of preferring that such organizations not exist. The proposals in the "Grand Design" ran up against the obstacle of the federalizing nature of the EEC, Euratom, and the ECSC to which the British proposals gave no indication of recognition let alone of accommodation. As a consequence, there arose the suspicion that the British ideas, when they were proposed, were designed to prevent the coming to fruition of the EEC and Euratom or as an alternative to set up some amorphous organization within which the United Kingdom would be able to influence decisively the course of these new communities without participating in them. They showed essentially no appreciation of the fact that the six were prepared for closer union than the fifteen and were determined to proceed in the direction of closer union. As Professor David Mitrany wrote: "British governments have acquired a reputation among those who are working for European unity offering, whenever some proposal is put forward, a reactionary rather than a helping hand. Their attitude always appears minatory, always suggesting *surtout pas de zèle*."[28] The fact that such an easily detected attitude exists might have suggested the wisdom of making proposals which came nearer to meeting or overcoming this attitude, but the unhappy fact is that they were not so designed.

[28] *European-Atlantic Review*, Vol. 7 #2, Summer, 1957.

An examination of the proposed over-all assembly rather easily discloses that it would not work well, if at all. The first problem perhaps would be the matter of defense. Would Sweden and Austria, for example, both of which are members of the Council of Europe and presumably would be of the overall Assembly, desire to take part in the defense commission? Most probably not, and this is presumably the reason why this commission might be "apart." Would Portugal, not a member of the Council of Europe, be in the over-all assembly at least to discuss defense matters? Presumably yes, but then the over-all Assembly is growing beyond the bounds of the framework upon which it theoretically is being organized. What would be the role of United States and Canadian parliamentarians? Would they sit only for defense matters in this commission and not in the others? What would the commission "apart" do? If it is "apart," is it really a part of the Assembly?

The real problem is quite obvious. The fact of the matter is that the one over-all assembly would be at best a motley one with its participants playing differing roles in different capacities at different times depending on the matter they were discussing and whether or not it was within the competence of one community or another. Such an assembly might indeed debate and set general lines of policy in a theoretical sense, but this particular over-all assembly clearly would not be in any position to do so. It would have different powers and different membership for different objectives with overlapping competences which would make its work terribly confused or it too would degenerate into a debating society. A parliamentary assembly cannot be half consultative and half legislative in terms of membership. In addition, the pressures in European assemblies, even from British members, are to grant them some powers which take them out of the "talking club" category, a category to which the UK proposals inevitably assign them, a sort of parliamentary limbo. As for the communities of the six, they do have organizations with executive powers. The new assembly for the EEC and Euratom have some legislative powers and rights of review which are explicit in the treaties which brought them into being. There is a definite *raison d'etre* for their existence as communities having real powers of a supranational character in certain

functional areas upon which the countries of the six have decided to join forces in a type of federal arrangement. In these arrangements, the assembly now constituted is something more than a consultative body. It is taking on the character of a federal parliamentary assembly for certain functional purposes. It is to be anticipated that these assemblies will tend to attract experts in the subject matter with which they deal and thereby provide responsible parliamentary oversight and direction, in so far as provided by treaty (and perhaps beyond as they develop their strength and competence) into the activities of these communities. At the present time, a proposal is also being considered which would provide for the election of these representatives in the six countries by universal popular suffrage. This would tend to further substantiate their federal character and contribute to the development of the federalizing process going on among the six since the inception of the ECSC. This factual situation was not met by the British proposals which seemingly were made either with a lack of appreciation and real understanding of the course of developments among the six or with the hope that the proposals and the Free Trade Area might tend to arrest the federalizing process going on among the six nations which, for diverse reasons, have embarked on this course.

Surely part of the reason for the multiplicity of European institutions which has been deplored is the fact that the modern world is so complex as to require a number of different institutions for different purposes. This is even seen in any national government, where, given the complexity of modern economic and social life, there is a great deal more governmental interest and intervention in affairs in general. In a sense, the various institutions which have developed in Europe since the war have been a reflection of this fact. Parliamentary supervision or congressional supervision of the complex of agencies, commissions, and other functional institutions which have evolved in a national state have become ever more difficult even in a federal state such as the United States. The establishment of parliamentary assemblies in connection with new supranational or even intergovernmental institutions seems only reasonable and a possible answer to this problem. If seen in this light, the prolifera-

tion of European institutions might well seem not so much undesirable and unusual as inevitable and desirable.

What will come from the British proposals described herein is difficult to predict, though it seems clear that the six prefer maintaining the present parliamentary structure which will divide European institutions along the lines of the six in their communities and the fifteen in the Council of Europe which may or may not be amalgamated with the OEEC. Should the latter result upon the completion of the Free Trade Area negotiations, which seem likely to lead to some success if the common market shows itself viable in the next few years, the Council of Europe presumably would continue to be a cooperative intergovernmental organization along lines preferred by the United Kingdom government and the other eight members. As such, it might well prove to be an effective counterweight to the community of the six, keeping in perspective the fact of a larger area of European unity which might be lost if the six turned inward upon the problems of their new community. It is, however, hard to conceive of any compromise which would permit the carrying out now of the "Grand Design" proposal laudable as may be its objectives of seeking larger unity within the Atlantic Alliance and broader European cooperation within the Council of Europe. These objectives surely should continue to be sought, but by some means other than the proposed over-all assembly which neither takes account in a realistic fashion of the federalizing tendencies of the six nor of the parliamentary pressures for a European executive, at least in some areas, being responsible to a parliamentary assembly. These pressures exist both in the Council of Europe and within the six nation community. Within WEU, some compromise may well be reached which links the United Kingdom more closely in some form of association with its partners of "little Europe."[24] Here, too, even from British parliamentarians, pressures are likely to be exerted for more executive responsiveness on the part of the Council of Ministers to the Assembly. It may be that within this framework, something will come of the "Grand Design" proposals, but certainly in a very

[24] The recently announced agreement to pool British, French, German, and Italian armament production within the WEU framework seems an important step in this direction.

watered down version probably deserving of a much less magnificent description. The "Grand Design" foundered on the rock of the federalizing process in Western Europe. The pursuit of its overall objectives remains of decisive importance, however, and it will be interesting to observe whether some form of United Kingdom association with the six does not eventually emerge giving additional impetus to a broader European federation.

PART II

PROBLEMS OF ECONOMIC AND POLITICAL DEVELOPMENT

DEVELOPED ECONOMIC ATTITUDES AND THE UNDERDEVELOPED ECONOMY

John Kenneth Galbraith

THIS paper reflects on the impact of the economic attitudes of the economically advanced countries, both capitalist and socialist or communist, on those countries which, possibly sacrificing accuracy to tact, we describe as "underdeveloped." In dealing with the underdeveloped world, we are always in danger of overgeneralization. It should be clear that the focus of this paper is primarily upon the heavily populated lands of southeast Asia and most of all on India and Pakistan.[1]

It is my thesis that the economic orthodoxy both of the capitalist and communist world makes contact with the life and reality of the underdeveloped countries only after a far greater modification than is presently realized. The problem begins with the predominantly agricultural character of these countries and the radically different political and social circumstances that are implicit in a village economy. In India and Pakistan, great cities—Calcutta, Bombay, Delhi, Madras, Karachi—are, in any quantitative sense, on the fringe of the society. Eighty-three per cent of the Indian people live in the villages; and these number a nearly unimaginable 612,000.

The isolation of these Asian villages is something that can be both seen and felt. The thin, searching people, the mud and thatch, the patrol of silent cows, the meagre surrounding fields, all convey a sense of solitude. Village government is not highly developed, and the traditional tie to central authority has been the tax collector. There is no priest who is in communication with his hierarchy and no telephone or telegraph lines to the city. Often the village can be approached only on foot. Those who have approached it over the mud dikes or along the dusty paths in centuries past have been the agents of old oppressions or the harbingers of new misfortunes. At best they have been

[1] An earlier version of this paper, ***Rival Economic Theories in India*** and concerned specifically with that country was published in FOREIGN AFFAIRS July, 1958. I shall use the term Asia in discussing this area. It will be evident from the context that the paper does not apply to the Chinese mainland or to the lesser Communist areas.

bearers of promises that were never kept or prophets of reforms that were never made. Out of the depths of this experience the village has a deeply ingrained mistrust of the world outside, and this mistrust is directed first of all at those who presume to govern.

The economic life of the village is concerned, indeed preoccupied, with the production of food. And so, therefore, is economic life as a whole. Approximately half of India's gross national product is made in agriculture, and approximately 70 per cent of the people are directly dependent on agriculture for their livelihood.

Because food is important, so is land—the individual's relation to land is the clue to almost all other aspects of his well-being. Nothing so effectively secures such well-being as the ownership of land. Thus a problem that has all but sunk from the sight of the ordinary western economist becomes of preoccupying importance.

I do not suggest that the villages comprise the total of Asian economic life. India and Pakistan have an excellent transportation network—by far the best in Asia. In both there is a highly developed urban trading community. Long before Independence, India had a large and efficient cotton textile industry, the world's principal jute manufacturing industry, a small steel industry and some development in other fields. But apart from the textile mills, industry was a thin fringe. Much has been made of Indian (or Parsi) enterprise in building a steel industry. But prior to Independence, this had brought India only about a million tons of capacity. Canada, with similar colonial antecedents and only a minute fraction of India's population, had several times as much.

Our more recent attitudes toward these countries have been shaped by the developmental efforts and above all by the industrialization programs which have been launched since the end of World War II. In both Pakistan and in India, there have been Five Year Plans. These carry the unmistakable aura not only of advancing industrialization but of increasing social control over the economy. Obviously one doesn't have Five Year Plans in either a purely agrarian economy or under *laissez-faire*. India, as this is

written, is midway in the Second Plan. The first was devoted primarily, although not exclusively, to expanding food production and particularly to the development of large and small irrigation enterprises. In the Second Plan, the emphasis has been more especially on industry—on expanding the steel industry, on launching an engineering and machinery industry, on developing an electrical equipment supply, and so forth. The industrial expansion has gone forward under both public and private auspices. However, most of the new industries—in contrast with older ones that are being improved and expanded—are being developed under government auspices by publicly-owned corporations. This is being done as part of a formally proclaimed intention to develop a "socialist pattern of society." The commitment to the goal of a socialist society is central in modern Indian thought. It is regularly averred by the government and, indeed, by nearly all articulate Indians. Even the most intransigent Indian capitalist may observe on occasion that he is really a socialist at heart. In other southeast Asia countries, the commitment to socialism is not much less strong. Certainly in none does the idea of strong state leadership in resource development and allocation encounter important resistance.

This reiterated reference to socialism is extremely important for an understanding of these economies—or, to speak more precisely, it contributes greatly to the failure to understand them. The word socialism, like a reference to a five year plan, implies social control of the economy by the government. It is easy, as a result, to imagine that the Indian economy is managed by the government and that other Asian governments have in their hands the necessary instruments for similar control. Clearly a great many foreigners, both East and West, share this illusion. Nothing could be farther from the fact.

The Indians are indeed engaged in a substantial effort to expand their economic plant and its output. Both by choice and by necessity they are doing much of this under public auspices. Yet, by almost any test, the economy of India is less responsive to public guidance and direction than that of the United States. Indeed, it is one of the world's least controlled or "planned" economies. In the United States, the several levels of government dispose of about twenty per cent of total production (of $434

billions in 1957). In India the corresponding figure is not over ten per cent.[2] By this test—the size of state activity in relation to all activity—more than twice as much of the American economy is managed or planned by government as is the case in India.

No one should make too much of these figures. Military outlays, which are a sizable part of our figures, may not be a useful index of resources under social control. But even outside the field of direct public activity, our economy is subject to a far greater degree of public guidance and direction than that of the Asian countries. Our agriculture is much more subject to control and is more extensively controlled by the state. The agriculture of the Asian villages is only gradually being brought within the purview of the counterpart of an extension service. Wages, hours and conditions of labor are much more extensively regulated in the United States, and in one way or another we can do more about manpower supply. Taxation and fiscal policy are subject to the same manipulation in free enterprise Washington as in socialist India, and in our case the tools in the hands of the government are almost certainly more efficient. Our industrial pricemaking is subject quite generally to the administration of large corporations. As a result, it is decidedly more restrained than the truly free markets of India and Pakistan.

In the aggregate, there can be little doubt that ours is both much more manageable and a much more managed economy than that of the Asian countries. India has superimposed a smallish socialized sector atop what no doubt is the world's greatest example of functioning anarchy. Her neighbors differ only in having an even smaller industrialized and socialized sector.

To these economies come both the prophets of Communism and Western capitalism. It can easily be argued that both fail to make contact with them. There is at least some slight comfort in the knowledge that the Russian difficulties may be as great as our own. Conceivably they are greater.

Our own difficulties are compounded of a failure to understand both the Asian economy and our own. It has long been

[2] For detailed comparisons of a slightly earlier date, see Harry T. Oshima, "Share of Government in Gross National Product for Various Countries" *American Economic Review*, June, 1957.

remarked that, where economic wisdom is concerned, we have both a domestic and an export product. The domestic product is an intricate blend of pragmatism and compromise. It abhors government intervention in principle but not in practice. Social security and social insurance, a variety of subsidies and controls, a policy for containing depressions and inflation, a farm policy, and a resource development policy are all recognized to be either essential or desirable. We are categorically opposed to government intervention only when it is categorically for someone else's benefit. This social pragmatism—this accommodation to circumstance—far more than rigid adherence to doctrine accounts for what measure of economic success we have enjoyed.

But the common export version of American economic policy is very different. This is a pure distillate of boisterous enterprise and undiluted *laissez-faire*. Rugged individualism and rigorous competition are the thing. Men who wouldn't think of taking this medicine themselves unhesitatingly prescribe it for foreigners. Particularly, it is what is needed to stir Asians out of their age-long torpor. Thus lurking just below the surface of nearly all our formal relations with these countries is the suggestion that they should forthwith dispense with socialism and go in for free enterprise or capitalism. All would be well for them and all would be well between our countries.

As I say, such rejection of the state, in contrast with its pragmatic use, reflects a misreading of our own experience. The misunderstanding of Asia lies in the failure to see the unique inapplicability of the free enterprise formula—either in its pure or diluted form—to that part of the world. As noted, the Indian commitment to the semantics of socialism is at least as deep as ours to the semantics of free enterprise. (Nothing is more engaging than the way both countries affirm in principle what they find so inconvenient to put into practice.) And until recent times a good deal of capitalist enterprise in India and elsewhere was an extension of the arm of the imperial power—indeed, in part its confessed *raison d'être*. As a result, free enterprise in Asia bears the added stigma of colonialism, and this is a formidable burden.

But much more important, it is very doubtful if free enterprise is either functionally or socially applicable to these countries. In all the Asian countries but especially in India, economic advance

is a political imperative. Perhaps—just perhaps—if development were left to market incentives, it would proceed as rapidly as under public auspices, or more rapidly. But suppose it did not. Suppose the private vision and entrepreneurship were lacking. Or the capital. Who can be sure? Did the Indian subcontinent lag behind the West in the last century and the early part of this one because the British repressed growth or because of more deeply seated causes? If more deeply seated and enduring factors prevented rapid development in the great age of enterprise, then to count on free enterprise now would be a dreadful risk. Who can be sure that things have changed? It is a risk that American prophets of free enterprise, were they based in New Delhi or Karachi rather than New York, would be reluctant to take.

There are also the social consequences of capitalism to reckon with. Left to itself, as the specifications would require, capitalism is a system of manifest inequality. Inequality has ceased to be a thing of great social urgency in a country where opulence is general. It still has grave and even revolutionary implications in a country where nearly everyone is poor and where many are hungry. Anyone who is familiar with Asia will also be aware of the talent of its people for conspicuous consumption. This is a part of the world where the rich are rarely discreet.

I have been adverting to the pure or export version of capitalism. But the pragmatic version which we in fact employ is not more relevant. It too leaves initiative mostly to the private firm with the consequent risk that in Asia it will not be forthcoming in response to market incentives. Inequality remains considerable, and it obviously is not open to the Asians to use our particular devices for reducing the resulting tensions. In our case, unemployment compensation, old age insurance, minimum wage standards, farm price supports, and above all a generally rising real income all help to blunt the impact of capitalist processes on the ordinary individual and in doing so, they help to make tolerable the wealth of the well-to-do. These social luxuries comparatively speaking are unavailable to the governments of the Asian countries. A good deal of our social regulation, imperfect though it is, also requires a precision and subtlety of administration which is beyond the reach of these governments.

In the last few years a remarkably aberrant phrase, "people's

capitalism" has come into official use to characterize the modern American system. It is presumed to describe a system in which ownership of the means of production is widely distributed through the medium, principally, of widely held securities. The case for a broad distribution of such ownership rests, invariably, on a bogus use of statistics. (Among other things, individual owners are, in effect, counted as equal regardless of the size of holdings, and their holdings are, in fact, highly unequal.) Share ownership also has been of minor importance as compared with increased income or improved social legislation in softening the tensions of capitalism. But even though the synthetic talk about people's capitalism has little relevance to the United States, it has no meaning at all for countries where the masses of the people will never, if they own anything at all, own more than a minute patch of land.

Thus to talk in Asia of the virtues of capitalism, classical or modern, is to make little or no contact with the realities of Asian economic life. The person who does so serves only to deny himself influence except with a handful of businessmen. Our situation is partly redeemed by the fact that on the whole Americans adhere badly to a popular creed or an official line. Large numbers of the people whom we have actually on the ground—State Department, technical assistance and information service personnel and businessmen—have seen or sensed that this part of the world cannot follow our example. It is not our habit to conceal our convictions on these matters even though it may be wise to exercise a measure of discretion in the presence of visiting legislators and tycoons. I imagine that many Indians, for example, know that many Americans take a pragmatic view of their policy.

Yet how much better it would be if inapplicable ideology did not supervene at the top. One cannot be in Asia without feeling that most of our efforts at understanding consist in laboriously trying to undo the damage of those who presume to make policy in Washington. In our society there is an unquestioned correlation between the majesty of official position and the irrelevance of the generalizations that are pompously articulated.

The Russians also have problems. In contrast with the expo-

nents of *laissez-faire* capitalism, they undoubtedly show a capacity to accommodate doctrine to circumstance. The difficulty is, however, that the Soviet Union is a full-blown example of socialist planning and these countries, as I have noted, could scarcely be farther from this goal. Russia is the most managed and centralized society in the world. Both its industry and its agriculture are subject to a formidable apparatus of control. Objectives are pursued with the rigor and determination of an old authoritarian tradition. Nothing could be more strikingly in contrast with the minimal guidance to which, say, the Indian economy is subject. And, one ventures, nothing could be less in keeping with Indian temperament and the character of the ruling Congress Party than the vigor and on occasion the violence of Soviet governmental techniques. No one has suggested that Indian socialism is revolutionary socialism. On the contrary, it identifies itself wholly with the tradition of non-violence.

Thus while Russian accommodation to Asian attitudes is considerable and certainly greater than in the days of Stalin, one can reasonably conclude that there are still difficulties. Russians must negotiate the chasm between a country that is genuinely socialistic (in the Soviet sense of the term) and a country that chooses to call itself socialist but, in fact, is at the opposite pole in actual organization. The Soviet leaders cannot tell a friendly socialist country that it is no such thing, nor can they make recommendations which accept the fact of a total absence of central control. Russians are more or less under the obligation to believe that Asian socialism is what it is not.

While I was in India in 1956, I had some opportunity to familiarize myself, directly and indirectly, with the general drift of Soviet (and associated) economic comment on India. It seems to be recognized that Russian and East European agricultural experience is inapplicable to India. But other agricultural suggestions strike one as having a rather uncertain or even academic tone. The remnants of feudalism and exploitation should be abolished. This is easier to suggest than to reduce to blueprints. The "surplus product" in agriculture should be appropriated for the needs of development. The question of how to do this is far more difficult, especially in a country where the governing party is extensively identified with land ownership.

One of the most serious Indian problems involves the adjustment of investment as between the public and the private industrial sector. So far as there is a Soviet formula for dealing with this problem, it must, inevitably, be to discriminate sharply against the private sector. Given the importance of this sector for earning foreign exchange and the scarcity of managerial talent, as well as the vested interests of part of the Congress Party, this has the same unrealistic ring as proposals for universal free enterprise.

One senses that even Russian attitudes toward the socialized sector, at least as they emerge in the attitudes of sympathetic Indians, have been but slightly adjusted to Indian conditions. The Indian Five Year Plan is treated as though it were indeed a master industrial plan for the administration of all economic resources. There is much concern for matching and reconciling inputs and outputs in different sectors. And there is a heavy-industry mystique.

In fact, the Indian Five Year Plans have their kinship not so much with the *Gosplan* as with a Western capital budget that has been spread out to provide for industrial capital formation.[8] The urgent questions are not those of matching inputs and outputs and rates of growth; these are rather readily solved. The infinitely more difficult questions are those of maximizing foreign exchange resources, and of getting the maximum of domestic saving and capital formation with the minimum of inflation. With these problems it would not seem that the Soviet attitudes make appreciable contact. In post-revolutionary Russia a massive development of heavy industry could seem the *sine qua non* of survival. And in World War II this proved to be the case. The development of heavy industry can readily be defended in India, but it would be hard to say that it has unique urgency as compared with food, clothing, medicines and like products for her vast population.

Finally in the Asian countries, there is the peculiarly difficult problem of reconciling efficiency and maximum growth with the

[8] A point that was indeed made about the First Five Year Plan by M. N. Rubinshtejn, a Soviet writer on Indian economic development on this and other matters concerning Soviet attitudes. I am much indebted to Mr. L. Kirsch's "Soviet View of the Indian Economy" published elsewhere in this volume.

political pressures and religious preferences of the people. Some of these pressures—the Gandhian emphasis on cottage industry with the resulting limitations of factory production, for example —are decidedly inimical to growth. In the past, Russian comment on Gandhi and the economic policies of his followers was invariably contemptuous, but of late there has been a marked tendency to rationalize these policies as very desirable. They are seen as the alternative to capitalist textile production and a solution to the admittedly tragic problem of village unemployment. Neither position reflects the realities of the Indian situation. This requires a sympathetic view of the religious preferences and the problem of unemployment but fairly strong resistance to restraints on factory enterprise or the diversion of scarce capital to village industry. For this would mean merely more privation over an even longer time.

In fact, neither an advanced capitalist country like the United States nor a highly organized economy such as that of the Soviet Union has an economic formula that is immediately applicable to Asia. It is perhaps especially unfortunate that among those who fail to recognize this are a great many Asians themselves. Indian Marxists, who are a considerable and influential group, naturally assume that the formula for India's future is given by Marxist-Leninist doctrine and current Soviet experience. It is to these (and in recent times also to China) that they look for essential guidance. I sense that little effort is made to modify this doctrine in applying it to the Indian scene. And plainly, much of it is as remote from the realities of the Indian life as are Marx, Lenin and the modern Soviet leaders in time or temperament.

A very much larger number of Indian economic leaders look for guidance to the sophisticated economic theory of the West. To be in communion with this doctrine is a mark of scholarly achievement. Again, no great store is set by its modification and adaptation to the Indian experience. As a result, an astonishing proportion of the economics that is taught and discussed in India has little relevance to Indian problems. Indeed, some of the more refined theoretical models discussed are not notably relevant to the Western communities where they originated.

At the same time, it is becoming increasingly clear that in

India, the most advanced of the Asian countries in development, economic policy is at its best when it is most self-reliant. Adaptation of action to circumstances has on numerous occasions produced better results than the adoption of foreign models. The First Five Year Plan was a pronounced success at least partly because it reflected the enormous importance of food in the Indian economy. Perhaps the greatest success of both the First and Second Plans has been the Village Development Program. This effort, designed to establish communication with the villages, to lift the level of their technical achievement, stimulate the use of their latent resources and improve the quality of their life, reflects the importance of the village in Indian economic life and is adapted to the mood and aspirations of the Indian village dweller. It has no close counterpart either with the West or in the Communist countries. (While it serves some of the same functions, it is an error to identify it too closely with the modern agricultural extension service of an American state.) Perhaps the greatest unsolved problem of the Indians is to find some way to insure efficient public entrepreneurship under the general aegis of a parliamentary government. As I suggested earlier, there is no alternative to such entrepreneurship, and hence a solution of the problem must be found. On this question neither the United States nor the Soviet Union has much experience to offer. The one lacks the public corporations and the other the parliamentary democracy.

I do not suggest that the Asian countries have nothing to learn from the experience of the more developed lands. But I am persuaded that these lessons are not revealed in any comprehensive doctrine or theory and that this is equally the case with Western capitalism and Soviet Communism. The best Asians and the best friends of Asia will be those who first learn this lesson.

ALLOCATING DEVELOPMENT RESOURCES: SOME OBSERVATIONS BASED ON PAKISTAN EXPERIENCE

David E. Bell

Economic planning staffs have been established by now in most of the underdeveloped countries. One of the most important questions with which these staffs are faced is how best to allocate the resources that are available for development. Which industries should be started? What should be the priority of investment between agriculture and industry? Should schools be favored over power plants?

The views of the planners may of course be irrelevant to practical events; they may or may not affect the actual distribution of resources, depending on the nature of political and of market forces, the position of the planners in government and their persuasiveness, and many other variables. Nevertheless the question is inescapable. Governmental and private leaders alike want to know what would be the "ideal" allocation of development resources. Planning staffs must answer.

If they turn for guidance to the writings of economists they will find that quite a substantial set of ideas concerning resource allocation has been developed in recent years. The leading exponents of these ideas would be the first to point out that they are as yet incomplete and do not meet all the questions which are encountered in practice. Additions and changes are steadily being proposed. Nevertheless these ideas have sufficient logical completeness, and sufficient relevance to reality, to merit being called a theory of allocation.

This theory was applied, so far as feasible, in the preparation of the Pakistan First Five Year Plan. The purpose of the present paper is to discuss briefly the extent to which the theory proved to be useful in that case, and to suggest one or two practical steps that might be taken to bring theory and practice into greater harmony.

Elements of Allocation Theory

It is necessary to begin by mentioning, in somewhat simplified fashion, the essential elements in the theory of allocation usually

suggested by economists.[1] They are two. The first is the idea of efficiency—of choosing from among the available alternatives those investments which will result in the maximum progress toward the country's development objectives. The second is the idea of consistency—of choosing a set of investment projects in which inputs and outputs are balanced and all scarce factors are fully committed. Put the two ideas together and one pictures the planners as calculating costs and returns for alternative projects in the different fields of developmental activity (and for alternative technologies for those projects where there is a choice), and selecting that set of projects which is at once mutually consistent and most efficient in producing economic growth. If the selection is properly made, no included project could be replaced by an excluded project without losing some of the possible gain in development.

The concept of efficiency of resource use in underdeveloped countries is not a simple one. For example, it has been suggested that market prices in underdeveloped countries will ordinarily diverge substantially from equilibrium prices (i.e., those prices which would achieve the full use of all available factors of production), and consequently that calculations of investment costs and returns should be based on "shadow" or "accounting" prices rather than market prices.[2] Moreover, it is evident that the net return on an investment from the national viewpoint may differ markedly (in either direction) from the private profit which would be earned on it.[3] In addition, the relative efficiencies of two development projects will depend not only on which will bring the greater gain in income, but also on which will lead to greater subsequent saving and investment.[4] Furthermore, the de-

The writer served in Pakistan from 1954 to 1957 as an adviser to the Planning Board, Government of Pakistan. The views expressed in this paper are of course his own and do not necessarily reflect those of the Board.

[1] I rely in what follows on two recent expositions of the theory by two of its leading proponents: J. Tinbergen, *The Design of Development* (Baltimore 1958), and H. B. Chenery, *Development Policy and Programmes* (Santiago, Chile: Economic Commission for Latin America, 1957. Mimeographed). While neither of these works was available when the Pakistan Plan was being prepared, the main ideas could be found in earlier publications. Moreover, Professor Chenery served for some months as a Consultant to the Pakistan Planning Board in 1955.

[2] Tinbergen, *op. cit.*, pp. 39-41, 85-7; Chenery, *op. cit.*, pp. 27-8.

[3] Tinbergen, *op. cit.*, pp. 37-8.

[4] *Ibid.*, pp. 35, 37.

velopment objectives of a country are necessarily multiple (larger national income, reduced unemployment, improved distribution of income, etc.), and cannot be expressed in terms of a single goal to be maximized.[5]

In order to take account of these and other complications, the methods which have been proposed for applying the allocation theory in practice are fairly elaborate, involving mathematical programming techniques. Nevertheless, however complex the method of application, the twin ideas of efficiency and consistency remain the basis of the theory.[6]

These ideas appear to be simple and powerful, capable of being explained to politician and public as well as technical expert. They would seem to offer an objective standard by which a development program can be determined and defended without recourse to fallible personal opinion.

The Pakistan experience offers some confirmation and some challenge to these assumptions. The ideas of efficiency and consistency were explicitly adopted as the basic criteria for choosing projects for inclusion in the Pakistan Plan.[7] They were found to be relatively easy to explain, and proved acceptable to nearly everyone concerned as a conceptual basis for decision-making. In practice however they could be applied only with major limitations.

Three main difficulties are discussed briefly in the present paper. First, the theory does not yet seem to offer a satisfactory basis for allocating resources to purposes where no marketable product is involved. Second, lack of data sharply limited the extent to which the efficiency criterion could be used. Finally, in view of both these difficulties, it was not possible to achieve an objective solution to the problem of multiple objectives.

These are serious limitations. It might be well to state at the

[5] Chenery, *op. cit.*, p. 6.

[6] "The main analytical problem in formulating a development program is to find a solution which is at once consistent with the expected demands and resource limitations and efficient in its use of resources." Chenery, *op. cit.*, p. 48.

[7] See Government of Pakistan, National Planning Board, *The First Five Year Plan* (Karachi, December 1957), Chapter 5. (Hereafter cited as *Pakistan First Plan.*) A third criterion, administrative feasibility, was also given prominence in the Pakistan Plan. Although an explicit criterion of feasibility has much practical usefulness, it need not concern us here. It will be understood that only feasible projects should be considered for inclusion in a development program.

outset however that the final conclusion was by no means a negative one. Even in the Pakistan case the allocation theory was of considerable value. And in large part the limitations encountered in the Pakistan case could be removed by appropriate programs of research and investigation. Nevertheless there remain some doubts that the theory will serve the needs of planning agencies without considerable further development.

The Problem of Incommensurable Returns

To apply the allocation theory requires the calculation and comparison of net returns from alternative investments. The first major limitation in the use of the theory is that no such calculations are possible with respect to a good many elements of a development program.

The difficulty arises in two ways. One is that capital investment in many cases—roads, schools, hospitals, for example—results in no marketed product. It may be possible in a few instances to impute a value to the output.[8] But in a great many cases it seems rather doubtful that monetary returns on such investments in "social overhead capital" could be calculated, for comparison with the return on alternative investments in, say, shipyards or rayon plants.

A second way in which the difficulty arises is that to a considerable extent the allocation process—at least as practiced in Pakistan and India—is concerned with activities which are not investment at all, in the customary economist's meaning of a net addition to physical assets. The Pakistan Five Year Plan, for example, includes proposals to expand the agricultural extension system, to begin a series of comprehensive surveys of water resources, to enlarge the geological survey organization, to increase the staff of the national industrial research organization, to hire more teachers in schools and colleges, and to do many other things the essential characteristic of which is the provision of services, not the construction of assets.

These activities obviously do not fit neatly into the standard allocation theory which is concerned with choices among alternative capital investments. The economist's first question will

[8] See Tinbergen, *op. cit.*, pp. 43-45 for an example of imputing income to the construction of a road.

therefore be: must we include such activities in a development program? The services of teachers, researchers, and extension agents are normally classified by economists as consumption, not investment. Could we not simply ignore them, and restrict the scope of development planning to the planning of investment?

There may well have been uncertainty in the past about how to answer this question, but evidence of two kinds seems now to give a definite answer. First, the productive possibilities of increased educational or research services have been noted in many underdeveloped countries. In Pakistan, to take only a single example, the introduction of hybrid corn increased the yield on some farms near Peshawar by upwards of 60 per cent in one year.[9] In such circumstances, the training of additional agricultural extension agents might well result in a larger growth in national output and income than any alternative use of resources. Those concerned with planning economic development would therefore seem to be required to deal with what might be called "developmental services," as well as with capital investment.

Second, it is by now well established that past gains in production in advanced countries have come as much from increases in the quality of labor and capital inputs as from increase in their quantity.[10] Although we know little about how to accomplish desired changes in the quality of factors, it would seem likely that research, education, extension services, perhaps even health services, would have some relevance—indeed as we learn more about economic growth we might well find that to plan wisely the expansion and improvement of these services might be at least as significant for a country's progress as to plan its capital budget.[11]

[9] The figure is approximate. It was given to the writer in 1956 by Shippley McIntosh, then Chief Agriculturalist for the U. S. economic aid mission in Pakistan.

[10] "Between the years 1899 and 1953 (in the United States) . . . productivity gains . . . accounted for more than half of the 3.3 per cent average (annual) rate of growth in real product." J. W. Kendrick, *Productivity Trends: Capital and Labor,* (National Bureau of Economic Research, Occasional Paper 53, 1956) p. 8.

[11] "Underlying . . . (the) conventional definition of investment is a more fundamental concept which is broader; namely, any use of resources which helps increase our output in future periods. And if we attempt to broaden the operational definition, then a number of additional categories of expenditures would have to be included, principally those for health, education and train-

For these reasons, the decision by planning authorities in Pakistan, India, and other countries, to concern themselves with these "developmental services" seems well founded.[12]

In the case of most of these developmental services, as in the case of the construction of schools and roads, no market price attaches to the result. In consequence, over a considerable range of services and investments included in a development plan like that of Pakistan, quantitative comparisons of relative efficiency of resource use are not easy to make. These are not small fringe areas, but substantial and important segments of the plan. While no precise estimates were made in the Pakistan case, activities of these types might account for as much as one-fifth of the total outlay proposed under the Plan.[13] How could allocations be made in these cases?

What was actually done in Pakistan (and presumably in other countries facing the same problem) was to seek bases for judgment which would be defensible by rational argument though not by objective tests. Two questions required answers. First, given the total resources available for development purposes, how much should be allocated to education, to health, and to each of the other sectors of the Plan? Second, given the allocation to each sector, how should it be sub-allocated among purposes and projects? In the standard allocation theory, both questions are answered simultaneously as projects within a sector are compared with each other and with projects in other sectors. As the margin is approached, the allocation among sectors, and among projects within sectors, is uniquely determined. In the absence of quantitative data, other methods are necessary.

As an illustration, the allocations to education in the Pakistan Plan might be cited. Allocations were made *within* the education sector to a series of major sub-sectors (primary education, sec-

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ing, and research." M. Abramovitz, *Resource and Output Trends in the United States since 1870*, (National Bureau of Economic Research, Occasional Paper 52, 1956), pp. 12-13.

[12] There is a separate question about the propriety of the practice followed by the Pakistan and Indian planning authorities in lumping together capital costs and current outlays and identifying the total as the "size" of the development program. This practice raises difficult problems of definition and consistency, which are suggested by the discussion on pp. 129-131, *Pakistan First Plan*.

[13] Rough figures calculated by the writer from data in *Pakistan First Plan*, Chapter 3.

ondary education, teacher education, etc.), and within those sub-sectors to scores of individual projects (the establishment of new teacher training colleges, the improvement of existing training colleges, the commencement of research on teaching materials, etc.)[14] These allocations were made by the Planning Board on the recommendation of its small but expert Education Section.[15] The Section made its recommendations following a careful survey of the situation of the schools and colleges, a review of the many studies that had been prepared in previous years, and extensive consultation with the country's educational leaders. Each of the hundreds of projects which were proposed by different governmental (and some private) agencies was analyzed. Recommendations were made not only on all these projects, but also on many policy issues having to do with educational methods, organization, financing, etc.

This was work of great range and detail. The Section early formulated, however, and the Board adopted, a statement of "priorities" which was intended to furnish a clear basis for decision in individual cases. These priorities were stated explicitly and with some precision.[16] For present purposes, only two excerpts will be quoted. The formal rationale underlying the priorities was stated as follows: "the priorities were designed, first, to obtain maximum results from the use of scarce resources; second, to ensure as perfect an integration as possible of the educational plan with the general development Plan; and third, to achieve an equilibrium within the educational plan itself."[17] The priorities themselves were summarized as follows: "It is necessary first, to consolidate, that is, to fill up the gaps and make up the qualitative deficiencies that exist in the present educational

[14] The allocation among thirteen sub-sectors is shown on page 590, *Pakistan First Plan*. The allocation among individual projects was not published in view of the massive detail necessarily included; official and complete lists of projects in mimeographed form were of course circulated to all concerned in the Central and Provincial Governments in Pakistan. The illustrative projects listed in the text are hypothetical.

[15] The Section was headed by B. A. Hashmi, later Vice Chancellor of Karachi University. G. F. Gant, then of the Southern Regional Education Board, later Representative of the Ford Foundation in Pakistan, served as consultant to the Planning Board on Education and Training during the first half of 1955, when the bulk of the decisions were taken.

[16] See *Pakistan First Plan*, pp. 543-4, also pp. 589-90.

[17] *Ibid.*, p. 544.

structure and secondly, having regard to the resources available, to make a modest expansion in the system."[18]

This statement of priorities formed the basis for hundreds of specific decisions, large and small. For example, in the field of primary education, the important (and highly controversial) recommendation was made that, even though only about half the children of primary school age were in school, resources during the First Plan period should be devoted mainly to improving teacher training, teaching materials, and other quality factors, rather than to expanding the number of schools and teachers offering the existing standard of education. The justification for this recommendation was clear: it was considered that the greater educational impact on the country's children could be obtained in this way, foregoing a poor education for some children in the short run in the interest of a better education for many more children in the longer run. For another example: proportionally greater resources were allocated to technical and professional education, and to secondary education, than to primary or to college education. The justification was that the deficiencies in the system were relatively larger in the favored fields, and the urgency of improvement therefore greater—a judgment which could perhaps be translated as a distribution of resources designed to yield the greatest educational return per unit of expenditure.

To a close observer it seemed evident that the educational planners made extensive use of the concept of allocating resources to what were judged to be their most efficient uses, and of the concept of selecting projects which would be consistent both with each other and with the rest of the development program. An argument might be made therefore that the criteria of selection used in the education sector were essentially the same as those used in industry, or power, or agriculture.

Two considerations, however, greatly reduce the potential impact of such an argument. Even granting that the general criteria of efficiency and consistency are conceptually applicable in a sector like education, does this advance us very far, so long as

[18] *Ibid.*, p. 544. The full statement of priorities, and indeed the full discussion of education (Chapter 27) in the *Pakistan First Plan*, are of considerable interest from a number of viewpoints other than that of the present paper.

the criteria have to be applied by subjective judgment rather than objective measurement? If we cannot measure the efficiency of a proposed educational project in some quantitative fashion, have we a transferable set of standards that can be used by different persons under different circumstances to obtain verifiable results? Or have we instead only a logical and persuasive verbal formulation, whose application will depend on the judgment of the person using it?

Furthermore, in so far as the educational planners were seeking to apply a criterion of efficiency, their object was efficiency in achieving educational results. This is clearly a different thing from efficiency in achieving national income results, though there may well be some (as yet unknown) functional relationship between the two. To this extent the criterion of efficiency is not comparable in application to the education sector and to sectors with marketable products.

In spite of these considerations, the writer was, and remains, impressed by the apparent logic and force which characterized the pattern of allocations within the education sector in the Pakistan First Plan. Recognizing the potential danger of concealing different ideas under similar names, it would still seem to be desirable to investigate further how far concepts of efficiency and consistency can be applied to such sectors.

As for allocations *between* education and other sectors (agriculture, industry, etc.), the problem was met with less assurance. Some partial answers were available by applying the criterion of consistency: the engineers called for by the development program in industry had to be provided by the educational program for training engineers (allowing some slight margin for importing engineers from abroad). Such input-output relationships were helpful in establishing reciprocal limits for allocations to different sectors in some cases.

But the consistency criterion was not enough by itself. The crucial question remained: how could the value of the marginal allocation to education be equated with that to industry? How could the Planning Board be sure that its allocation to education was appropriate in relation to its allocations to agriculture, irrigation, power, etc.?

No satisfactory answer was found to this question. The Board

established a general limit that no more than about 20 per cent of the total development resources should be allocated to the "social sectors" (Education, Health, Housing, and Social Welfare). It was not clear however that anything more supported this limit than the fact that 20 per cent had been the approximate allocation for these purposes in development plans previously prepared by India and other countries. Professor Tinbergen has suggested that it might be helpful to calculate the returns which are foregone in a market sector by allocating marginal resources to a social sector.[10] But clearly the question of judgment remains; suppose it is known that the funds requested for a college laboratory would if used in the industrial sector establish a small textile factory. The returns from the two alternative investment cannot be compared in simple quantitative terms.

In the writer's observation, the Planning Board in fact attempted to do approximately what the standard allocation theory suggests—that is, to reach a (subjective) judgment on the relative values of the marginal investment in the different fields. The Board did face a series of specific questions which posed the issue sharply. There were proposals, for example, to increase the allocation for education by a certain amount in order to increase the number of new secondary schools, or to raise the pay of teachers and thereby attract more able persons to the profession. These proposals were considered to be just sub-marginal at the existing level of the total allocation to education. They therefore raised the precise issue whether resources should be transferred to the education sector from agriculture, industry, or some other sector. The Board was forced time and again to make such choices between realistic alternatives, and to decide whether to put marginal resources into education or agriculture, into housing or irrigation. In making such choices the Board clearly attempted to weigh the comparative "importance" of the alternatives to the country's development, and the relative pros and cons were discussed at length.

Nevertheless these judgments were necessarily highly subjective. Few were defensible by objective standards. And it might be difficult to defend the proposition that these judgments by the Planning Board, at the present stage of knowledge about

[10] Tinbergen, *op. cit.*, p. 30.

such choices, were any more "expert" or "rational" than those which might be made in the normal political process.

The example has been used here of the allocations to education. Similar points could be made about the other non-investment and non-marketable elements of the development program: about extension and advisory services for agriculture and for small industries; about research in agriculture, industry, transport, and other fields; about health, and housing services and construction. In all cases careful studies were made. In all cases logical bases were sought for allocation decisions—and the results were frequently strongly plausible, especially decisions as to allocations within sectors. Nevertheless personal judgments, sometimes quite arbitrary judgments, necessarily played a large part in the final decisions, especially in the decisions as to allocations between sectors.

Needless to say, none of this is meant as criticism of the Pakistan Planning Board, which in the writer's view proceeded as rationally as any planning agency has yet done and more rationally than most. The problems described are general and have not been solved anywhere to date.

But the matter should not be allowed to rest here. Could the logical foundations for allocations be improved? Several possibilities suggest themselves.

First it may well be possible to base more judgments on quantitative data. Tinbergen's suggestion regarding the use of imputed returns in the case of road construction has already been cited. The principle might well be applied in certain other cases. One might visualize, for example, some sustainable figure representing the estimated effect on agricultural output of the marginal agricultural extension worker. Business firms in the United States seem to be able to make some quantitative estimates of the anticipated returns from their expenditures on research[20] and some appropriate translation of such figures might be found applicable to underdeveloped countries.

Both theoretical and practical investigations might be made into the question whether quantitative values can be adduced for

[20] See the evidence cited in Y. Brozen, "Scientific Advance as a Factor in Economic Change," *Scientific Manpower—1957* (Washington: National Science Foundation, 1958).

"personal capital."[21] Can a trained person be regarded in some sense as the result of investment? Can anything be done to measure the present value, considering likely future earnings, of an engineering education, a medical education, even a B.A. degree? Is it possible to estimate the average increase in energy (and earning power) of persons cured of malaria, and to compare this with the per capita cost of malaria eradication?

In these and other respects there would seem to be large opportunities for research in a field which has hardly been touched. Nevertheless, it seems likely that quantitative data will not provide answers to all questions of allocation—perhaps not even to very many. The complexities of trying to give a quantitative evaluation to the product of, say, a new secondary school, are obvious and quite possibly insurmountable.

Second, even where quantitative calculations are not feasible, it might be possible to make use, in some sense, of the concept of maximizing returns from scarce resources. Is it possible to demonstrate, for example, not in financial terms but nevertheless decisively, that a particular allocation of funds will lead to maximum results in terms of the research, the educational, or the health "output" needed in a country? Decisions of this type are constantly being made in connection with public and private budget decisions. Research might establish some generalizations capable of application to the problem at issue here.

Finally, the allocation process might be improved if we know more about the role of research, education, and extension in past cases of economic development. What part did these things play in the development of the U. S., the U. K., the U.S.S.R., Japan, etc.? What policies and programs were successful in those cases? What mistakes were made? What measures seem likely to be useful in today's underdeveloped countries?

The types of research and investigation suggested here should improve the allocation process. Nevertheless the theorists might well consider the question of what guidance they can give to practitioners for dealing with a situation in which some allocations can be made on an objective, quantitative basis, but some

[21] The phrase is that of J. K. Galbraith in *The Affluent Society* (Boston, 1958) p. 270.

must be made on the basis of subjective personal judgment. This seems likely to be the real situation for some time to come.

The Problem of Inadequate Data

By far the larger part of a development program will normally consist of investments having marketed (or marketable) products. Conceptually, this part of a program is much easier to deal with. The allocation theory was designed for such investments. Here, however, a second major limitation to the use of the theory is encountered: lack of data. This limitation offers no theoretical challenge. In practice, however, it is a formidable obstacle to an attempt to allocate development resources rationally.

The data problem is considered here briefly, using the Pakistan experience for illustration. It will be convenient, though considerably over-simplified, to consider two main categories of data: market and cost data on individual projects, and general data on the economic system as a whole.

The theory assumes that market and cost data are available for all relevant possibilities for investment. In Pakistan, market and cost data were available in relatively few cases. Data were submitted to the Planning Board relating to certain large industrial projects proposed to be built by the Pakistan Industrial Development Corporation (a Government-owned corporation), and to the large Government irrigation and power projects. It was possible for the staff of the Planning Board to make rough but useful estimates in several additional cases—notably cotton and jute textiles. For the great bulk of potential investments in small and medium-scale industry, in agriculture, in small-scale irrigation projects, and in transport, however, the data were quite inadequate to form the basis for quantitative estimates of anticipated returns from different projects.

This was not all. Even where data on markets and costs were available, their reliability was low. For example, a survey of several large-scale industrial projects recently completed in Pakistan shows that final costs in some cases were as much as 260 per cent of those predicted in the project reports, with the

average being about 160 per cent.[22] Moreover, the data available did not include estimates of comparative costs of alternative technologies.[23] Nor did the data available normally include estimates of secondary costs or benefits from a project (for example, the additional investment required of the railways to carry the ore and coal for the proposed basic steel mill). Finally, no estimates were offered of the external economies and dis-economies likely to arise as a result of a project (for example, the training in technical and managerial skills which would result from the establishment of the steel mill).

This is a formidable list of deficiencies in the data. It meant that only in two or three dozen cases—principally large-scale industrial projects in the public sector—could comparative returns be calculated on alternative investments.[24] And even in these cases important elements of cost or return were usually missing and the data that were available were somewhat unreliable.

The calculations that were made were helpful in differentiating among projects: it seemed highly probable, for example, that returns would be considerably greater from proposed investments in cement and fertilizer than in steel and jute. And even though the projects for which data were available were few in number, they were mostly large. Together they accounted for perhaps 30 per cent of the total outlay proposed in the Plan.[25]

[22] Data taken from a Planning Board staff document dated February, 1958. The plants in question included several different industries: cement, paper, sugar, jute, chemicals, etc. Many of the original cost estimates had been prepared by foreign engineering consultants with considerable international experience. The problem undoubtedly lies more in the inherent difficulty of cost estimation in underdeveloped countries than in any lack of experience or attention to detail on the part of the estimators.

[23] In only one case did the Board have such data in anything resembling satisfactory form. This was the case of handloom textiles, for which estimates were prepared by H. G. Aubrey, Consultant to the Planning Board on Small Industries in 1955, and submitted in his paper "A Scheme for the Re-equipment of the Handloom Industry," dated May, 1955.

[24] Details are beyond the scope of the present paper. Some readers might be interested to know, however, that two types of return were normally calculated: (1) the anticipated return (profit and interest) per unit of total capital (borrowed and equity, fixed and working); (2) the anticipated net saving or earning of foreign exchange per unit of total capital. Some of the early calculations (made under the guidance of Professor Chenery) used a shadow rate for foreign exchange. Later when Pakistan devalued her currency, it was concluded that the new official rate was so close to the previously selected shadow rate that separate calculations would not be worthwhile.

[25] Rough figures calculated by the writer from data in *Pakistan First Plan*, Chapter 3.

Nevertheless it remains true that in view of the lack of data the allocation theory was sufficient only to establish relative priorities among certain projects—and a considerable degree of uncertainty attended even these priorities. Relative priorities among certain projects did not carry the Board very far toward the objective of allocation among sectors, and was only a partial solution to the objective of allocations within sectors. In many cases—virtually the entire agriculture sector, for example—it was not possible to measure prospective returns on investment in the normal sense.

Other bases for decision were found. For example, the priority (a very high one) given to expenditures in the agriculture sector was based on such general considerations as the obviously large opportunities for increased agricultural output in view of Pakistan's low per-acre yield, the importance of increasing Pakistan's food production to eliminate the need for imports, and the fact that increased production of export crops provided the only chance in the short run for increased foreign exchange earnings. These considerations are relevant and powerful. They are not sufficient however to provide an evaluation of any particular investment project. In the absence of project data, decisions on particular projects in the field of agriculture had to be based in a majority of cases on a subjective judgment as to whether the project in question seemed likely to make a substantial contribution to development objectives per unit of resources allocated. As in the case of agriculture, so with projects in the fields of small and medium-sized industry, small-scale irrigation, and transport. The precise and neatly interrelated calculations called for by the allocation theory could not be made.

Data on individual projects were thus scanty. So also were more general types of information. The allocation theory requires data on the flow of income to consumption and saving, the foreign balance of payments, the money supply, prices, and other types of general information. Only with such data on hand can investment allocations be made which will fit appropriately with the general flow of products, incomes, and factors in the economy. In Pakistan, data on the balance of payments, the banking system, and the money supply were fairly good. On the

other hand, data on prices and on incomes, consumption, saving, and investment were particularly scarce.

Using such general information as was available, the Planning Board found it possible to prepare (1) estimates of total requirements for development expenditure which were consistent with expected changes in income, saving and capital inflow; (2) estimates of foreign exchange requirements for development which were consistent with expected changes in exports, imports and external sources of financing; and (3) estimates of anticipated availability of certain resources (notably cement and professionally trained workers) which were consistent with anticipated requirements for them. Furthermore the three sets of estimates were consistent one with another.[26]

Even though these various estimates were prepared in some cases with the help of fairly heroic assumptions, it could nevertheless be said that the development program as a whole fitted together: it was internally consistent and it was appropriately related to the nondevelopment activities of the economy so far as those were known. Moreover the Planning Board was not aware of any opportunity for making more rapid progress[27] by replacing an included with an excluded project. These are clearly virtues, even if they have a somewhat negative ring.

With data so scarce and so inadequate, however, the actual allocation of resources in Pakistan was undoubtedly far from ideal. And it is plain that a vigorous and broad-scale program of investigations is of major importance to improve the basis for rational allocation decisions. Presumably the situation is not markedly different in other underdeveloped countries. Allocations will have to be based in large part on subjective judgment until substantially more data become available. What are the chances of rapid progress in obtaining the needed information?

It is not hard to see how better data could be obtained. One of the strongest impressions borne in upon a planning adviser in Pakistan (or, no doubt, any other underdeveloped country) is the wide range of opportunities for more investigation of invest-

[26] *Pakistan First Plan,* Chapters 9 and 11, contain discussion of financial and foreign exchange requirements and resources.

[27] The word "progress" must of course be understood in terms of the objectives of the Plan, which included an improvement in the geographical distribution of the national income as well as an increase in its total.

ment possibilities. Many possible lines of investment have not been explored at all. Most have been looked into less than adequately. One has no difficulty in conceiving a vastly expanded and improved series of investigations into alternative investment prospects in agriculture, industry, transport and other fields.[28] Nor is it difficult to think of ways to improve the supply of general economic statistics.

The difficulty comes in visualizing where the investigators will come from. Virtually none of the staffs and organizations that have done so much in advanced countries to institutionalize the process of innovation exist in underdeveloped countries. Research, planning and engineering staffs in business firms; private consulting firms; government and private research laboratories; government statistical organizations exist, if at all, in rudimentary form.

Some work of great value to the underdeveloped countries can of course be done in the research centers of the advanced countries—indeed the contribution of such centers could be far larger than it has been till now. The great bulk of the necessary investigations however will have to be done in the countries concerned. They must be based on the local resources, price structure, factor endowment, etc. Not only must the investigations for the most part be made locally. They must also be made in large volume. Hundreds and thousands of studies are required in a country like Pakistan, ranging from studies of individual plants, farms and other economic units to studies of national parameters such as rates of saving for different groups of income receivers.

To undertake work of such range and variety it is apparent that foreign consulting firms, foreign statistical advisers, etc., can only be useful on a stopgap basis.[29] There is no real alternative to the relatively slow process of developing research and planning organizations in the underdeveloped countries, which will inevitably require years of effort.

[28] For an example of a carefully designed program of investigations of the type needed, see J. D. Black and H. L. Stewart, *Report on the Research, Teaching and Public Administration of the Economics of Agriculture for India*, (Delhi: Government of India, 1954), Part I.

[29] They would be most useful, it would appear, in training local staffs, rather than in carrying out surveys themselves. The more training the foreigner does, the larger is his multiplier effect. Yet too often the single survey is all he is asked to do and the total extent of his impact.

Nor is this all. To a considerable extent, the survey methods and research tools that are needed have not yet been developed. Consulting engineers are not accustomed to calculating the additional burden on municipal health or educational services which will result from the establishment of a new factory. Nor are they used to weighing the relative advantages of one large project versus several smaller ones in terms not only of profit rates but also of training entrepreneurs. Yet these are illustrative of the kinds of questions which must be tackled if resources are to be properly allocated.

Two conclusions might be warranted. First, even counting generously on assistance from foreign consultants, it would seem likely to take many years in most underdeveloped countries to obtain data of the extent and quality required to make reasonably precise allocation decisions in accordance with the standard theory. One can of course expect the data situation to improve steadily. Second, to plan the organization and improvement of research, survey and investigation units should be an important element in any development planning effort. Such activities seem likely to yield very high returns indeed.[30]

The Problem of Multiple Objectives

A third major problem encountered in attempting to apply the allocation theory was that of reconciling divergent objectives. It has already been noted that the objectives of a development program are inevitably multiple. In addition to an increase in the national output and income, other objectives commonly cited are: more employment opportunities, an improvement in the balance of payments, and greater equality of income distribution.

Given several objectives, how are planners supposed to reach decisions? The allocation theory seems to provide fairly clear answers, along two lines. First, some of the objectives tend to merge when "shadow" or "accounting" prices are used. Thus the objectives of maximizing national income and of maximizing

[30] To avoid misunderstanding it might be well to note that the above discussion of allocation in the market sectors implies no judgment about the desirable degree of government control over private action. The choice of policy instruments for effectuating desirable allocations raises a series of issues not discussed in the present paper. (See Tinbergen, *op. cit.*, Chapter 4; Chenery, *op. cit.*, Part III.)

employment will tend to come together when mathematical programming methods are used, since they permit the simultaneous determination of allocations and "accounting" prices for factors such that output will be maximized and factor supplies fully used.[31]

Second, other objectives can be considered as restrictions (in the mathematical sense) on the available choices. Thus, if it is determined (politically) that a given degree of income equalization is to be an objective of the development program, the allocation process could be described as one of choosing that combination of projects which, while satisfying the criterion of consistency, *and achieving the desired degree of income equalization,* will yield the largest possible growth in income.[32]

These methods could not be used in the Pakistan case to reconcile objectives. The reasons were the familiar ones: the theory does not deal satisfactorily with outlays on non-marketable activities, and where marketable activities are concerned, data were too scanty to permit full use of the theory.

Five objectives were stated in the Pakistan Plan: (1) to raise the national income; (2) to improve the balance of payments; (3) to increase opportunities for employment; (4) "to make steady progress in providing social services," and (5) "to increase rapidly the rate of development, especially in East Pakistan and other relatively less-developed areas."[33]

The Board was not able to reconcile the first three objectives through the use of mathematical programming methods involving "accounting" prices (although, as indicated earlier, some use of accounting prices was made in evaluating certain individual projects). However, the Board did not find much difficulty in reaching some practical reconciliation of these three objectives. There were few, if any cases in which the ranking of projects in

[31] Chenery, *op. cit.*, p. 31. Needless to say, the above statement assumes among other things a high degree of technical substitutability between capital and labor.

[32] Tinbergen, *op. cit.*, pp. 36, 79-80.

[33] *Pakistan First Plan*, p. 13. A broader statement of the social purposes to be sought through the development process, in the context of the new Constitution of the Islamic Republic of Pakistan, is to be found in Chapter 1 of the Plan. This Chapter, largely written by the late Mr. Zahid Husain, first Chairman (1953-56) of the Pakistan Planning Board, is a notably forthright discussion of the necessity for radical social and cultural change if economic progress is to be achieved.

reference to the national income objective differed from their ranking in terms of the balance of payments objective. Where such cases appeared, the Board's inclination was to give priority to the latter objective. Nor were there many cases of conflict between the national income objective and the employment objective. In cases where there was some conflict, the Board tended to give priority to the income objective.[34]

The relative ease with which these three objectives were reconciled no doubt resulted in part simply from the paucity of information on alternative investments (including alternative technologies). The Board faced few clear-cut issues requiring a choice among objectives. It did face some. In the case of handlooms, for example, the issue of conflicting objectives was posed sharply and the Board reached an unequivocal decision.[35] Nevertheless, as more data become available, the number of issues involving conflicts in objectives can be expected to rise. The attractions of a precise solution by programming methods will obviously be great.

The fourth objective—the increase of social services—is not ordinarily listed among the objectives of development programs. Presumably most planning agencies consider that this objective is incorporated within the broader objective of raising the national income, and need not be stated separately. The Planning Board in Pakistan, however, was impressed as indicated earlier by the difficulties of treating the output of social services in a national income framework. Moreover the Board wished to stress the point that such services have an ultimate as well as an instrumental value. The Board emphasized, for example, that education was desirable as an end in itself, and not simply as a means for training people to produce goods and services.[36]

[34] These priorities are indicated, though not stated with precision, in the discussion of "objectives of industrial development," *Pakistan First Plan*, pp. 406-7.

[35] The handloom case is discussed at *Pakistan First Plan*, pp. 475-8. At last reports the Board's recommendations, which would be supported by most economists, were being given less weight by the Government than were the political pressures for subsidizing handloom weavers.

[36] "Not only is it necessary to enlarge rapidly the number of trained persons in the country in order to carry out the various development schemes . . . but also the provision of educational opportunities is one of the primary goals of a society believing in equality of opportunity and the paramount worth of the individual." *Pakistan First Plan*, p. 539.

Consequently the Board listed an increase in social services as a separate objective. The operational significance of this decision, however, cannot be ascertained. As indicated above, allocation decisions concerning social service outlays were necessarily made on the basis of subjective judgment rather than objective measurement. There is no way to tell whether these judgments would have been different had there been no separate listing of a social services objective. Nor can it be said that there was any identifiable conflict between this objective and any other. It would seem necessary to leave the matter in this rather unsatisfactory position until we have gained a better understanding of the relations between the social services and economic development.

The fifth and last objective specified in the Pakistan Plan had a very clear operational significance: it was meant to recognize the political necessity of striving for equal progress in the two wings of Pakistan. For various historical reasons, there was a difference in the economic circumstances of West and East Pakistan at the time of partition from India. This difference was accentuated in the years immediately following by greater investment and income growth in West Pakistan. The economic disparity between the two wings of the country had become by 1953 an explosive political issue in the less favored East Wing and geographical parity had become the clear policy of the national Government. The Planning Board therefore worked from the beginning toward the objective of equality in development as between East and West Pakistan.[37]

The objective of geographical equality turned out to be unattainable in one five year plan period—neither the investment projects which would be necessary to reach such a goal, nor the administrative capacity to carry them out if they had existed, were available. This created a severe political problem for the

[37] Whether or not this was the wisest policy for the country to follow from the standpoint of development might be debatable. Unfortunately the very extensive political and journalistic comment in Pakistan on the problem of East-West relations has been accompanied by a virtually complete absence of scholarly investigation and analysis. It is to be hoped that this lack will soon be rectified as the case is of general interest; it represents a classic example of immobility of labor between two parts of a single country—two parts, incidentally, which under the Constitution have equal representation in the national legislature.

Planning Board in attempting to prepare a Plan which could be agreed to by the Central Government and the provincial governments of East and West Pakistan; one result was to delay the formal acceptance of the Five Year Plan by about eighteen months.

Our only interest here, however, is in the problem of reconciling objectives. In order to strive for more rapid economic progress in East than in West Pakistan, the Board did include in the Plan some projects, located in the East, which would yield lower returns than would some projects, located in the West, which were excluded.[38] Thus far the Board acted, as the allocation theory suggests, to restrict its effort to raise the national income by the necessity to improve the geographical distribution of income. A smaller gain in total income was accepted as the price of a greater equality of income.

On the other hand, the Board was clearly reluctant to sacrifice very much income, and refused to include in the Plan numerous proposed projects located in the East Wing on which returns promised to be quite low. Instead the Board preferred to allocate to the East a sizeable block of resources not committed to specific projects in the expectation that suitable projects, showing high returns, would be found before the time came to spend the resources.

This was of course an evasion of the issue, or rather a postponement. In the future the Board is likely to have to face more directly the question of how much income loss is justified by a gain in equality. The political position seems to be very firm: geographical equality in economic welfare as between the two wings of the country would undoubtedly be described as an overriding objective. But the political position might be reconsidered when the economic cost, if any, of equality is known.

[38] Note that this did not necessarily mean that economic opportunities were less attractive in East than in West Pakistan, only that the very inadequate investigations which had been made in the two wings (even less adequate in the East than in the West) had turned up a larger number of promising projects in the West. No one knows what the balance of opportunities will be when more adequate investigations have been carried out. The Planning Board found no reason to assume "any significant difference in the magnitude of potential economic opportunities between the two Wings; the present inequality in the rate of development is attributable to past history." *Pakistan First Plan*, p. 75.

Conclusions

The conclusions warranted by the foregoing discussion would appear to be these:

1. The theory ordinarily suggested by economists for allocating development resources does not serve the full needs of planning agencies, which must deal with investments and services that do not have marketable products. The ideas of efficiency and consistency which underlie the theory may hold promise of application to such allocation problems. Both empirical research and theoretical analysis are needed to investigate the problem further.

2. The allocation theory requires, for application to choices where marketable products are involved, a range of data vastly in excess of that available in most underdeveloped countries. Years of energetic and wisely directed effort would be needed in any country to obtain the needed information. Such an effort would seem to be itself a high priority use of scarce resources.

3. The methods suggested by the theorists for reconciling the divergent objectives of development programs cannot be fully used in practice because of conditions 1 and 2 above. As these conditions are progressively overcome, the extent of conflict among objectives will become clearer, and the political choices necessary to reconcile conflicts may be more sharply posed.

FOODGRAINS POLICY IN EAST PAKISTAN

Frederic C. Shorter[1]

Goals

East Pakistan is the home of approximately 46 million people crowded together on the combined deltas of the great Ganges and Brahmaputra rivers. It is among the least developed agricultural regions of monsoon Asia. Four-fifths of its crop land is devoted to rice in a tedious struggle to feed its growing population. Until 1947, this land was the greater part of Bengal, famous for the wartime famine of 1943. Since 1947 it has been part of a new country, Pakistan, comprising two wings situated in isolation on either side of India.

Independence gave rise to many aspirations. Among them was a hope that something might be done at last to feed the population better. There are many changes in the quantities and kinds of food which would constitute an improvement. An increase in the availability of rice has been stressed above all others. Rice accounts for between one-third and one-half of all consumer expenditure. Even a small percentage increase in the supply of such an important article of consumption would be a great achievement.

During the decade, three essential goals have been stressed which are: (1) to increase the *per capita* level of foodgrains consumption; (2) to reduce the instability of foodgrains prices; and (3) to protect vulnerable groups from the full impact of severe shortages when they occur.

The policies by which East Pakistan has sought to achieve these goals will be described and contrasted with results in the following sections.

Production Policies

The fundamental means of achieving higher *per capita* consumption is to produce more foodgrains. If more crop production is to be obtained, however, it must come from about 8 million peasant proprietors who farm almost every acre of cultivat-

[1] The author served as an adviser to the East Pakistan Planning Board from June 1956 to December 1958. However, the views expressed are not necessarily those of the Board. Use was made of unclassified materials collected by the Board for which the author acknowledges his great debt.

able land. Farming is labor intensive and traditional in technique. Commercial inputs are seldom used. Farms are typically three or four acres scattered in eight or ten plots largely devoted to rice. One or two plots on each of about two million farms are planted annually in jute, the export crop of Bengal.

This is subsistence agriculture in the sense that the level of real income barely sustains physical life. However, neither individual farms nor the region as a whole are self-sufficient. Trade and the use of money penetrate the economy at many points. No precise measures are available, but estimating from data on the value of jute production, the percentage of the population dependent on the market for food, and qualitative rural studies, it appears that possibly half the output of agriculture is sold for cash.

Prior to independence, agricultural development was neglected. Since then, there have been "grow more food" projects and, commencing in 1955, the First Five Year Plan which gives first priority to agriculture. The new emphasis on raising agricultural production is expressed through a number of official programs. First, there is an attempt to carry knowledge of new techniques and organizational assistance to farmers through extension services and rural community development programs. Second, the government has started the production, or import, and distribution of agricultural inputs such as improved seeds, fertilizers and plant protection materials. Finally, public investment is being made in land improvements, canals, structures, and pumps for the control of water supplies. Plans have been formulated for agricultural credit, but their implementation has lagged far behind other aspects of the development program.

Some idea of the magnitude of the development effort can be had from the First Five Year Plan (1955-60). It envisages an expenditure on agricultural development spread over the five years which would equal about 15 per cent of the annual value of agricultural production. This investment is expected to yield an increase in annual foodgrains production of about 8 per cent, and about 10 per cent in all agricultural production.[2]

[2] These relationships are calculated from the final version of the Plan issued late in 1957. In the Draft Plan, issued in May, 1956, production targets were about one-third higher.

PRODUCTION TRENDS

Official production statistics are widely criticized for their unreliability. It is not possible here to examine the details of how they are collected and the numerous theories concerning their possible biases, but only to assert a conclusion. The data are probably a good indicator of the direction of annual change and a rough measure of trend over a number of years. As a measure of the absolute amount of production, however, they are probably least reliable. The Food Department, which is not itself responsible for the statistics, takes a similar view of the data.

In the ten years from 1948 to 1958, there appears to have been a small increase in production. A straight line trend fitted to the data shows an improvement of approximately six per cent.[3] Since the calculation is based on data which are statistically weak and subject to considerable random variation as a consequence of weather, flood, and plant disease conditions, this estimate of trend might be characterized as an "impression."

A second impression, based on independent data, is obtained by totalling the changes induced by each separate development activity. This method was used to calculate the crop production targets of the First Five Year Plan on the assumption that all actions proposed in the Plan would be taken. It is also useful as a method of estimating actual accomplishment, although there are two limitations. First, it is difficult, both conceptually and practically, to identify the precise production effects of projects. For this reason, as well as administrative reasons, results are not carefully observed everywhere and recorded in official reports. Second, the aggregate estimate of change compiled in this manner does not reflect production changes taking place beyond the immediate impact of governmental development activity.

In mid-1958, a review of progress under the First Plan was undertaken in order to make a new forecast of the probable change in production between the pre-1955 period and the end of 1959. The preliminary results indicate that the largest possible increase in foodgrains production that can be expected is about five per cent. If the pace of expansion is, at most, about one per cent per annum with the impetus of the Plan, it was surely less

[3] Basic data and trend equations are presented in Table I.

TABLE I
Production, Net Imports, and Total Supplies of Foodgrains
(In thousand long tons)

	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958
PRODUCTION											
Rice[a]	6,712	7,519	7,914	7,146	7,097	7,832	8,050	7,427	6,748	8,111	7,526[c]
Wheat	20	19	23	20	23	24	24	26	22	23	24[d]
Production[b]	6,749	7,556	7,957	7,184	7,139	7,875	8,092	7,473	6,790	8,152	7,569[e]
NET IMPORTS											
Rice	96	167	132	75	214	112	6	3	533	432	380[g]
Wheat[f]	15	126	10	18	71	87	43	8	52	75	120[g]
Imports	111	293	142	93	285	199	49	11	585	507	500[g]
Exports	—	—	—	21	—	—	17	8	—	—	—
Net Imports	111	293	142	72	285	199	32	3	585	507	500[g]
TOTAL SUPPLY											
Supply	6,860	7,849	8,099	7,256	7,424	8,074	8,124	7,476	7,375	8,659	8,069[e]

[a] Consists of three crops, the main winter rice harvested in November-December and shown under the following calendar year because then it is available for consumption, and the summer and autumn rice of the same year.
[b] Details do not add to totals because other grains have not been shown separately.
[c] Autumn rice is included using an average of the preceding three years.
[d] Estimated at average of preceding three years.
[e] Partly estimated from incomplete data.
[f] Includes wheat products.
[g] Based on import program, most of which has already been executed.

Trends fitted by method of least squares
Production = 7503 + 41 (Year—1953)
Net imports = 248 + 34 (Year—1953)
Supply = 7751 + 75 (Year—1953)

than one per cent per annum before 1956.[4] Therefore, the estimate based on aggregate production data of a six per cent increase in production in ten years ending 1958 appears acceptable.

Population has increased during the decade, but on this statistical point, too, the precise magnitude is obscure. The National Planning Board estimates that the rate of natural increase is 1.4 per cent per annum for the nation as a whole. There are several reasons why the separate rate for East Pakistan might be lower. The Hindu population of Pakistan is concentrated in the eastern wing and the census record of the Indo-Pakistan subcontinent shows a lower rate of natural increase among Hindus than among Muslims. There probably have been fewer advances in health in East than in West, so that less effect on the death rate has been achieved. Finally, it is the net increase in population, including the effects of international, especially Indo-Pakistan, and inter-wing population movements, that is relevant here. On both accounts, East Pakistan has probably lost more people than it has gained.

With all these adjustments to consider, it is only possible to suggest a range of estimates for the decennial rate of population growth. The National Planning Board's estimate gives an upper limit of about 15 per cent. The adjustments might bring it down possibly to 10 per cent.

The difference between the rate of increase in population (10-15 per cent) and the rate of increase in foodgrains production (6 per cent) is the rate of change in production on a *per capita* basis. Therefore, production has fallen four to nine per cent *per capita* during the decade ending 1958. This measurement, like the ones on which it is based, may be characterized as an impression which is highly significant despite its lack of precision.

The failure of production policy to achieve a pace which at first would equal and later would exceed the rate of population growth appears to be the result of two factors. First, the size of the development effort is not large enough. It was only toward

[4] Only part of the First Plan period overlaps with the decade under consideration here. Its first effects would appear in the crop harvested the end of 1955 and shown in this analysis under the food (calendar) year 1956. Throughout, trends are used to gauge results because any particular crop is subject to the random influence of weather and flood conditions.

the end of the decade that a sufficiently large effort was planned. Actual accomplishments, however, are much less. Adequate budgets have been provided, but serious administrative problems and acute shortages of such critical resources as technicians and extension workers have blocked the way. Instead of achieving an expenditure on agricultural development from 1955 to 1960 equal to about 15 per cent of the annual value of agricultural production, the investment is likely to be only 10 per cent or less. The maximum result that can be expected to be achieved by the end of 1959 is to set in motion an expansion in production of about one per cent per annum. Thus, the most that can be expected on present projections is that production will soon be rising barely as fast as the lowest estimate of population growth.

A second limitation of production policy is that full advantage is not taken of monetary incentives which would urge farmers to produce more for the market. For example, land rents, which are paid directly to the government, have been frozen at pre-war levels despite a six-fold increase in the price of rice. Thus, a major incentive to produce and sell for cash has been allowed to wither away. The development program, itself, scarcely touches the possibilities of making extra production more attractive by improving foodgrains marketing. On the contrary, policies connected with government food procurement have been positively discouraging to production. They are described later in the section "Protection of Vulnerable Groups."

There are at least two reasons for such contradictions of policy. First, the new orientation towards economic development is not sufficiently strong to overcome adherence to old policies with non-developmental objectives. Equally important, however, is a widespread underestimation of the influence of markets on production decisions and, consequently, a skepticism about policy proposals that rely on market mechanisms for their effectiveness.

Import Policy

There is no simple rule which guides the year to year level of imports. Perhaps the best way of appreciating the complexity

of the problem and understanding the policies which have prevailed in the last decade is to list the main considerations usually taken into account.

The starting point is an estimate of the forthcoming year's "statistical deficit." It is calculated as soon as the first estimate of the main rice crop is available, which is toward the end of the calendar year.[5] This statistical exercise shows whether expected production (plus or minus planned changes in government stocks) will be sufficient to provide the desired level of supplies for consumption and other purposes.[6]

The desired level of human consumption is calculated on the basis of the recommendation of an official inquiry in 1945 that a minimum of 18 ounces per day per adult (or equivalent) should be supplied. Using this norm and certain statistical assumptions about population, the target for human consumption works out at approximately the same level as the actual level of consumption experienced on the average over the decade. Thus, the practical effect of the statistical deficit calculation is to show the level of imports needed to keep consumption at accustomed levels. The statistical deficit is something to start with, but it is not taken as conclusive, considering the known weakness of the statistics and the problem of prediction.

Great importance is attached to price behavior in the market as the winter crop is marketed. If price registers a "normal" seasonal decline, this is thought to indicate an average crop. If price increases set in early, or the starting level is not regarded as low enough, this is a sign that the deficit should be taken as larger than usual. There are no fixed statistical tests, so it is the judgment of senior officials concerning the significance of price movements that counts. In so far as the analysis of price behaviour gives an independent appraisal of the size of the crop, it is a useful check on the accuracy of production estimates used in calculating the statistical deficit.

[5] The main crop is winter rice, harvested in November and December, which furnishes about 70 per cent of annual production. Summer rice furnishes another 5 per cent and the remaining 25 per cent is provided by the autumn rice harvest.

[6] The other purposes considered are seed and waste.

Price movements are mainly a response to changes in the level of production,[7] but other factors, such as changes in jute export earnings or even speculation, are also influential. High prices, regardless of their cause, will impose great hardship on large sections of the community which do not have flexible incomes or reserve assets upon which to fall back. For this reason, the government is concerned to prevent "excessively high" prices even when they do not appear to be connected with a statistical deficit. There is no definition of what constitutes the maximum acceptable level of prices, but there is a definite threshold which shifts with changing economic and political factors. When that threshold is crossed, or appears imminent, larger imports are scheduled.

Implicitly, the guiding objectives are, first, to sustain consumption at levels at least as high as those experienced on the average in the past, and second, to moderate upward price fluctuations. Annual import requirements reflecting these objectives are fixed primarily on the basis of the statistical deficit and the analysis of price movements. Adjustments are made during the year as events appear to confirm or modify earlier expectations. Whether or not these import requirements are translated into a definite import program depends upon the national government's assessment of the availability of foreign exchange, of foreign aid, and of foodgrains surpluses from West Pakistan. The decisions which emerge from this interplay of considerations determine the flow of foodgrains into East Pakistan.

Trends in Imports and Total Supply

There have been imports[8] in every year since independence and the trend is upward. Imports furnished about one per cent of the total supply of foodgrains in East Pakistan at the beginning of the decade and about five per cent at the end.[9]

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[7] A crude test of this relationship is to compare the direction of change of production with the direction of change of the average price from one year to the next. Between 1948 and 1957, the expected inverse relationship prevailed in every year except one.

[8] Throughout this paper, imports include quantities from West Pakistan as well as from foreign sources. Small exports in a few years are deducted, so that the figures are all net.

[9] Refer to Table I for details and trend equations.

The effect of rising imports is to offset declining per capita production, and thus to limit the decline in per capita consumption. The result is seen in the trend of production plus imports (i.e., supplies), which has risen 10 per cent over the decade. Against this is the population increase of 10 to 15 per cent. Consequently, the trend of per capita supplies has been either constant or has declined by as much as five per cent. Consumption parallels supplies,[10] so there is a significant impression that per capita foodgrains consumption has not risen. It may have fallen.

This failure to achieve an increase in per capita consumption and increasing expenditures on imports has led to an interesting search for quick remedies. It is generally recognized that production is the crux of the problem, but illegal exports to India also attract great attention. East Pakistan has a land border with India of about 2,500 miles, most of it densely populated on either side. Across this border, it is said, go vast quantities of foodgrains. One view is that imports are needed only to compensate for smuggling to India.

The incentive to smuggle arises whenever prices of rice on one side of the border are higher than on the other side. A comparison of Indian and Pakistani prices, after adjustment for the black market value of the rupee which governs such transactions, reveals an incentive to smuggle to India in some periods and to Pakistan in others. There is no consistent pull towards India. In fact, there was a strong incentive to smuggle rice into Pakistan in 1956, the very year when official imports were highest at 585,000 tons.[11] Of course, there are also limits imposed by the regular border police as well as by the army which is stationed along the border to control smuggling during critical periods. It is in the nature of smuggling that no definite record is kept of the quantities moved, but the official view is that smuggling, although a recurring threat, is not sufficiently large to be the major reason for imports.

With the benefit of hindsight, it is clear that East Pakistan is

[10] The difference between supplies and consumption is changes in stocks, which largely cancel out over a number of years and seed, feed and waste, which are roughly proportional to total supplies. Thus, the percentage change in supplies is approximately the same as the percentage change in consumption.

[11] Long tons are used throughout.

normally deficit in foodgrains. As policy was made from year to year during the decade, however, this was by no means clear. First, there were no statistics for imports or exports of the region prior to 1947, because they were only kept for the larger political unit of which East Pakistan was a small, undefined part. Second, it was difficult to decide whether the first years were average production years or not since, with new boundaries cutting through old reporting areas and the general disorganization attending the establishment of a new country, little confidence attached to comparisons of production before and after 1947. After two good crop years in a row, in 1953 and 1954, plus a fall in prices, the government relaxed its concern over foodgrains supplies. The entire administrative apparatus for importing and distributing foodgrains was dismantled and, in 1955, all reserve stocks, except a meagre 64,000 tons, were unloaded on the market.

When, in 1956, a very poor crop followed an average crop of the year before, it caught the government by surprise. In a desperate race with time, the Food Department was re-established as a state trading agency, and a famine was narrowly averted by 585,000 tons of imports. The National Planning Board took a second look at its forecast of no food imports (net) over the period 1955-60, and revised the First Five Year Plan to allow for large scale imports.[12] The present outlook is that the government will be importing and distributing foodgrains throughout the foreseeable future.

Price Instability

One of the objectives of policy is the reduction of price instability. Import policy, in particular, aims to trim price peaks by increasing imports in periods of upward price movements. Some additional influence over market prices is sought by accelerating or retarding the speed at which imports are passed through working stocks and distributed. However, the small size of stocks and

[12] The final plan, published in December, 1957, allocates 2.18 billion rupees to foodgrains imports. This would pay for a reserve stock of one million tons plus three or four million tons for current consumption, the quantity depending on prices and the proportion of rice and wheat. About half of the total could be considered as available to East Pakistan.

rigidities in distribution commitments usually do not permit much action of this type.[13]

A further instrument of price policy is regulation of private stocks. Occasionally the government attempts to limit price rises by prohibiting producers, traders, or consumers (or sometimes all three groups) from holding stocks above prescribed amounts or for longer than short periods. Such "anti-hoarding" measures are extremely difficult to enforce, but are intended to drive more supplies into the market at critical periods and thus to limit price increases.

Imports, government stocks, and, to a small extent, private stocks are all regulated with the objective of preventing or limiting upward price movements. Such positive, anti-inflationary actions are usually withdrawn when prices subside, but no separate price supporting actions are taken to limit price depressions. For example, there is no policy at such times of encouraging, or even permitting exports, and accumulating government reserve stocks to withdraw surpluses from the market.[14] Thus, price policy is one sided. It leads to action during upward swings, but is passive in the face of price depressions.

The actual course of prices is shown in Chart 1. The years of highest prices are 1948, 1949, 1956, and 1957.[15] Three of those years are also the years of highest imports. In other years of the decade, imports were lower, and in the deep depression of 1954 and 1955, they were almost nothing. Thus, import policy appears to have worked in the correct direction to moderate price instability.

The price chart indicates that some improvement was achieved between 1949 and 1952. However, there was no policy to meet the serious depression which began in 1953. Thereafter, when

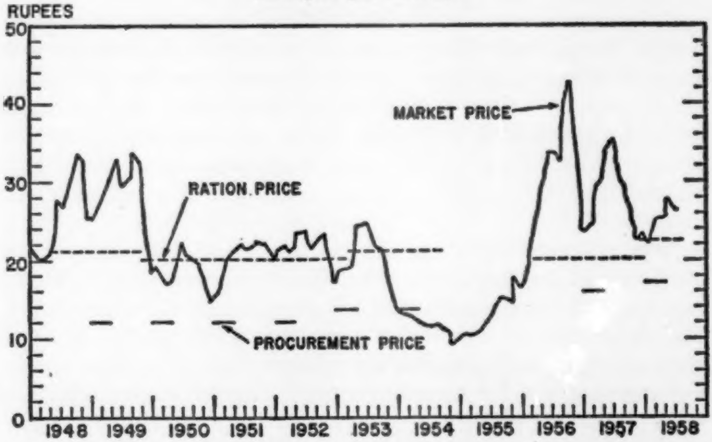
[13] The system of imports, internal procurement, and distribution is described fully in the section "Protection of Vulnerable Groups."

[14] In 1954, during an unexpected recession, the government purchased 125,000 tons at prices equivalent to the market price or above, thus giving some price support. In a sense, this was accidental because the procurement plan was made beforehand not to support the market, but to obtain rice to fulfill commitments in ration areas. Because the depression made market rice cheaper than ration rice, rations would not sell and the government had to hold the stock it acquired. In early 1955, while the depression was still in full swing, the government unloaded most of this rice onto the market. This was clear evidence that the government felt no concern for supporting the market.

[15] 1958 is left out since a full record for the year is not yet available.

RICE PRICES

(In rupees per maund)[a]



Market Price. Provincial average retail price of coarse rice.
Ration Price. Price at which consumers buy coarse rice from ration distributors.
Procurement Price. Price paid by government for coarse rice procured internally.

[a] A maund is 82⅔ pounds

the production failure of 1956 became evident, anti-inflationary policy and machinery to execute it had to be reactivated,[16] but it was too late to prevent a near famine situation from developing. 1957 was a better year, and 1958 promises to be better still. Apparently import and other policies are inadequate to do more than to avoid the most extreme price peaks. If conditions again favor a recession, there is no policy ready to prevent it.

Price instability is partly a consequence of underdevelopment. For example, crop yields depend more on the vagaries of floods and other natural conditions than on man's controlled use of water and fertilizers. Furthermore, farm consumption probably varies proportionately less than does production so that amounts marketed are more unstable than production itself. In this way, market responses to production changes are exaggerated. Marketing institutions and the services they need, such as transport

[16] Recall that the government's administrative arrangements for importing and distributing foodgrains were dismantled during the depression.

and storage, are poorly developed. Therefore, erratic price behavior is not easily checked by moving rice from low to high price localities or by adjusting stocks.

Finally, East Pakistan's economy is not sufficiently diversified. The volatile export earnings of jute generate strong inflationary or deflationary pressures on all commodity prices from time to time. Development of the economy would remove some of these causes of instability and would make others relatively unimportant, but this will take a long time to achieve.

Meanwhile, the most promising means of reducing price instability is to establish permanent food reserves. Reserve stocks, if large enough and skillfully managed, are immediately available to augment supplies whenever excessive price increases are apprehended. They allow time in which to readjust import programs when forecasts prove wrong and plans are revised. If the government has ample stocks, confidence is maintained and price fluctuations are less likely to be exaggerated by speculation. When it comes to price recessions, any excess storage capacity can be filled by internal purchases as an initial measure of price support. Stocks are also built up without spending valuable foreign exchange.[17]

Stocks adequate for these purposes are not carried by the private trade. Holding of stocks is discouraged by the high cost of capital and occasional harassment of the trade by the government when seeking emergency supplies. The most serious deterrent is the typical seasonal price pattern itself. In most years, the price drops from a fourth to a half as the new winter crop comes onto the market. Therefore, it usually pays to liquidate stocks before the main harvest rather than to hold carryover stocks. If anyone is to carry sizable stocks from one year to the next, it must be the government.

East Pakistan has made considerable progress in this direction. 250,000 tons of new permanent storage is already completed or under construction. By the end of 1959, the government will own, or be able to rent, about 500,000 tons of storage space. This, together with another 100,000 tons promised by the national

[17] An excellent discussion of reserve stocks is, "National Food Reserve Policies in Underdeveloped Countries," *FAO Commodity Policy Studies*, No. 11, Rome, 1958. It includes some case material on Pakistan.

government, will give East Pakistan, for the first time, the possibility of carrying an adequate food reserve.[18] The target is a basic reserve, located in East Pakistan, of 400,000 tons.[19] If food conditions are not too unfavorable, at least half of the reserve will be accumulated by the end of 1958.

However, it is difficult to finance reserve stocks and, subsequently, to exercise restraint in using them so that replacements are kept within the ability of the economy to pay for them. Food imports into East Pakistan for current consumption alone are costing between 250 and 300 million rupees each year (1956-58). That is more than the East Pakistan government's entire expenditure on economic development in fiscal year 1957-58. The initial cost of a 400,000 ton reserve, excluding storage facilities, is another 200 million rupees. Pakistan cannot finance such huge foreign exchange outlays unaided, so the possibility of establishing and maintaining a food reserve at the target level will depend greatly on the generosity of other nations.[20]

Protection of Vulnerable Groups

The hardship created by price fluctuations and associated changes in supply bears more heavily on some parts of the community than on others. If stabilizing measures were strong enough to hold fluctuations within a narrow range, the uneven distribution of the burden would not be very important. The problem of unequal burdens has not been solved in this way, however, because sufficiently powerful stabilizing actions have not been taken. In order to reduce the inequality, nevertheless,

[18] Past carryovers, which were regarded more as working stocks than as reserves, were as follows on January 1 of each year:

(In thousand long tons)

Year	Stock	Year	Stock	Year	Stock
1948	47	1952	49	1956	64
1949	45	1953	41	1957	105
1950	133	1954	124	1958	201
1951	165	1955	216		

[19] The national target is one million tons, of which the remainder would be in West Pakistan, but available in part for East Pakistan if necessary.

[20] Almost two-thirds of East Pakistan's imports in 1956, 1957, and the first seven months of 1958 (total, 1.5 million tons) were financed entirely by Pakistan's own resources. Foreign aid, although sizable, has not borne the main burden of food deficits in the past.

imported foodgrains are distributed in such a way that they produce more price stability for some consumer groups than others.

Selected groups are supplied with government foodgrains through a ration system at stable prices. Ration consumers are protected from market instability to the extent that their consumption is covered by the ration. Others, who depend on the market, must accept the full impact of fluctuations.

Market fluctuations are affected by rationing, but only indirectly. Consumers of rations demand less foodgrains than otherwise from the market, thereby exerting a downward influence on market prices. The deflationary effect, however, is not as great as it would be if imports were sold directly through the market. The sale of imports at ration prices instead of market prices leaves consumers with more money with which they can demand supplementary market rice and other things. The difference is that more market stability could be achieved by distribution directly through the market rather than through the ration system. However, by denying maximum price stability for those dependent on the market, the ration system secures substantial price protection for selected consumers.

The largest ration and, therefore, the most protection, is given to townspeople. Their ration is continuously available, although not always taken, at levels about as high as their usual consumption. Approximately 1.8 million persons are under town rationing. This includes most of East Pakistan's urban population which, however, is only four per cent of the total population.[21]

In the countryside, the most impoverished classes, usually landless laborers and the smallest cultivators, receive rations from time to time. In their case, the ration is suited to the situation, sometimes being available to many millions throughout the Province and at other times being withdrawn or offered only in certain localities. The level of the ration varies greatly, but is typically only a fraction of usual consumption.

Rations supply a small proportion of all consumption. The maximum, in 1956, was only 7.5 per cent.[22] Since perhaps 30 per

[21] The 1951 Census defined urban areas as municipalities or continuous collections of houses inhabited by at least 5,000 persons.

[22] See Table II.

TABLE II
Foodgrain Distributions[a]
(In thousand long tons)

Year	Towns	Countryside	Total[b]	Percent of Total Consumption[c]
1948	110	83	193	2.9
1949	119	207	326	4.9
1950	70	112	182	2.7
1951	89	115	205	3.0
1952	141	166	307	4.4
1953	74	64	138	2.0
1954	30	19	48	0.7
1955	—	—	136[d]	1.9
1956	177	359	536	7.5
1957	230	199	430	5.9
1958[e]	112	161	272	6.3

[a] Consists primarily of imported rice and wheat. Domestic rice procured by the government for distribution is also included.
[b] Details do not always add to totals due to rounding.
[c] Consumption is estimated as the trend value of total supplies minus ten per cent for feed, seed, and waste. See Table I for trend equation.
[d] No regular distributions were made, but in this year only stocks were sold to the wholesale market.
[e] First seven months only. Relationship to consumption (last column) also computed on seven months basis.

cent of all consumption depends on market purchases or rations, it is apparent that rationing protects only a fraction of those exposed to the instability of the market.

The principal economic justification for selecting townspeople for protection is that their incomes are, of all incomes in the Province, the least flexible. If prices rise or fall, the more advanced wage and salary systems of the towns cannot be adjusted easily. In the absence of rationing, the disorganizing effect of foodgrains price instability in the towns would seriously limit the growth of modern enterprise.

The poorest classes in the countryside are typically the first victims of starvation since they have no reserves upon which to fall back in a difficult period. The initial cause of distress is usually crop failure, which means that income also fails for those who have little or no production. In the typical course of a famine, the poorest groups face starvation first and begin to move towards the towns seeking employment and relief. Therefore, the strategy of famine prevention usually has two parts. First,

food supplies for the poorest groups are maintained at stable, ration prices near their homes. Second, income with which to buy food is bolstered. Public works, locally termed "test relief," are started. Emergency loans and other forms of relief are also given. By these methods, the government prevents famine and is usually able to relieve lesser hardships as well.

The value of ration protection to consumers is the saving over the market price which they enjoy. Chart 1 shows that the price of ration rice is relatively constant at or near 20 rupees per maund. This price is typically less and sometimes very much less than the price of market rice.[23] At times, the market price drops near or below the ration price, in which case rationing is withdrawn or ceases automatically as consumers turn to the market for rice.

In order to keep ration prices relatively low, as well as to maintain their stability, trading losses have had to be accepted at times. A particularly interesting feature of the ration system is that some of these losses are shifted to internal producers of rice by compelling them to furnish part of the necessary rice at relatively low prices. In the first few years after independence, about one-third of all government foodgrains were obtained by internal procurement. Since then, this source of foodgrains has declined in importance, so that it only accounted for four per cent of the total in the last three years (1956-58).[24]

Internal procurement imposes losses on producers because the price paid to them is typically much less than the alternative price which they could obtain for their rice in a free market.[25] Under one system of compulsion, cordons are placed around normally

[23] Imported wheat is also rationed. Comparative ration and market prices show similar differences.

[24] It should be possible to show the annual flow of government foodgrains by sources and uses according to the identity, Imports + Internal Procurement = Issues + Changes in Stocks. These figures are separately available in Tables I, II, III, and footnote 18. However, a further item for shortages has to be included on the right hand side. These are revealed each year when the carry-over stock figure is adjusted to agree with a physical inventory. Only in a few years do shortages appear unreasonably high (34,000 tons in 1954 is the maximum). Large losses apparently were due to spoilage of stocks, especially wheat flour, at a time when storage facilities were unequal to the task.

[25] Procurement and market prices are compared in Chart 1 as well as in Table III. It should be noted, however, that sellers seldom receive as much as the retail price. If the retail prices shown in Chart 1 were adjusted downward two or three rupees per maund, they would show more accurately the alternative for the seller. The comparisons in Table III take this factor into account.

TABLE III

Internal Procurement of Rice[a]

Year[b]	Procurement Price Compared with Market Price[c]	Form of Compulsion[d]	Quantity (In thousand long tons)
1947	Less	Cordons	80
1948	Less	Cordons	81
1949	Less	Levy	122
1950	Less	Levy	65
1951	Less	Levy	19
1952	Less	Levy	15
1953	Less	Levy	26
1954	More	None	125
1955	—	—	—
1956	—	—	—
1957	Less	Cordons and Border Levy	33
1958	Less	Border Levy	28[e]

[a] Or paddy (unhusked rice) in terms of rice.
[b] The procurement season is January through April.
[c] Procurement and market prices are also compared in Chart 1.
[d] Methods of procurement are explained in the text.
[e] Provisional total at end of procurement season.

surplus areas to prevent exports from the locality. To the extent that outside markets are successfully denied to traders, prices fall inside the cordon walls until producers are willing to sell to procurement agents at their price.

Another system is the levy. Surpluses of large producers are taken away after giving compensation at the procurement price. Under a variant of the levy system, travelling officers assess visible stocks on the spot and take any amount declared surplus. Recently, a special levy on surplus stocks has been in force in the five mile border belt. The border levy is primarily an anti-smuggling measure, but when the price paid is below the market price it is also a method of shifting losses to producers.

Compulsory procurement, although at first an apparently promising system, has proven to be a failure. The largest quantity was obtained in 1954 when the procurement price exceeded the market price and compulsion was not necessary. The first year of the levy, 1949, yielded a large quantity, too, but the public reaction was so strong that the criteria for calculating surpluses had to be revised in favor of the producers.

As internal procurement has diminished, imports have risen

until now the ration system is almost entirely dependent on imports. Before 1956, their cost was usually below the ration price so that no question of major financial subsidies arose. However, beginning in 1956, import prices were higher. The ration price of 20 rupees per maund required a subsidy of approximately 5 rupees per maund. At the end of 1957, the subsidy was cut in half by raising the ration price.[26]

The subsidy on imported rice is borne by the community as a whole for the benefit of ration consumers. If the competition of other uses for public funds should cause the subsidy to be withdrawn, there would be a further increase in ration prices. Fixed prices would still protect ration consumers from the market's instability, but the privilege would be somewhat less valuable than before.

Outstanding Issues

East Pakistan has not succeeded in raising per capita consumption of foodgrains. Instead, consumption has probably fallen. Foreign exchange is considered too scarce to solve the problem by importing more. No practical means of limiting population growth is in sight. The only escape is a more rapid rate of increase in production.

Raising agricultural production is largely a process of improving human organization and technique, aided by investment. However, production policy has not succeeded in setting this process in motion. This is characteristic of East Pakistan's entire economic situation. Progress occurs here and there, but a broad network of forces of economic expansion, each reinforcing others, is far from established.

Every policy that touches foodgrains is not, and probably cannot be, unequivocably directed towards solving the production problem. A larger flow of resources—human, material, and financial—into agriculture would build productive capacity more rapidly. Instead, the consumption of certain groups is protected by using foreign exchange and granting subsidies, both of which deplete the pool of resources available for agricultural development and other purposes.

[26] Based on average c.i.f. prices plus distribution costs of Southeast Asian rice. American aid rice was more expensive. However, most aid foodgrains were purchased against loans repayable in rupees which meant less cost in real resources even though the nominal financial subsidy was higher.

When internal procurement is based on compulsion cultivators are exposed to losses if they produce more than certain limits (the levy system) or produce for the market (the cordon system). This discourages urgently needed extra production. If the poor results of past procurement are also considered, it is easily argued that procurement of the compulsory variety should be abandoned. Nevertheless it continues to have a strong appeal. There is a sense of social justice about compulsory redistribution of rice from those thought to be consuming more food to those who have less. If done on a large scale, better spreading of internal supplies might also make a reduction of imports politically possible. This appears to be the reasoning of the revolutionary government which took power in October, 1958 and believes that strict enforcement can succeed where others have failed in the past. Controls over private stocks are tougher, cordons more extensive, procurement prices unchanged, and the procurement goal higher than ever at 200,000 tons for 1959. The problem of production disincentives remains unresolved. How important it is and whether it could be met by paying procurement prices based on market prices are questions left for the future.

The plan to have a permanent food reserve in East Pakistan also poses the possibility of more resources flowing into consumption and less being available for development. This will happen if the reserve creates an affluent disposition among policymakers. They may be encouraged to aim at relatively lower food prices on the average by making more liberal injections of imported foodgrains into the economy than otherwise. On the other hand, the reserve's existence need not encourage higher average imports if it is regarded essentially as an instrument for more timely, and therefore more effective, action against price fluctuations. It can reduce the need for imports if internal surpluses are purchased for the reserve during relatively low price periods. Finally, effective price stabilizing action would reduce the hardship of vulnerable groups and weaken their claim for special subsidies.

Choices between immediate consumption and investment in the productive capacity of the economy are difficult to make under any circumstances. In East Pakistan, the pressure of poverty and the government's need for public support have tended to make consumption the more attractive choice.

THE LOCATION OF ECONOMIC POLICY DECISIONS IN PAKISTAN

*Gustav F. Papanek**

THIS paper is concerned primarily with the locus in Pakistan of the power to affect general economic magnitudes—prices, the rate and nature of investment, the amounts and kinds of production. It does not deal with economic relationships between individuals and groups, e.g. the economic power of the landlord or factory owner in relation to tenant or worker. After an examination of the locus of the power to affect economic policy and the extent of general popular participation in the process, there follows a discussion of some of the economic consequences of this distribution of power. The political causes and consequences of economic power are undoubtedly important, but since this paper is written by an economist they are largely ignored.

This paper was written in the Spring of 1958 and substantial changes have taken place in the Government of Pakistan since then. However, these changes have had less effect in the area treated in this paper than in many others. While the paper discusses the situation as it existed early in 1958, most of it would apply subsequently. In a few places footnotes or the text cover subsequent developments.

THE LOCATION OF ECONOMIC DECISIONS

In general, economic power seems to be concentrated in fewer hands in less developed than in more developed countries. This is particularly true of Pakistan. Major economic decisions are made to a very large extent by government, and are concentrated in the Central Government and its Ministry of Finance. But even the economic power remaining in private hands is heavily concentrated, especially in the case of modern industry.

The proclaimed and frequently repeated policy of the government is for the maximum encouragement of private enterprise,

* This article was originally prepared for the Seminar on Political Forces in Pakistan at McGill University held in June 1958. The views expressed in this paper are of course the author's and do not necessarily reflect those of the Pakistan Planning Board with whom the author has served.

with government control restricted to the minimum necessary for efficient operation and growth of the economy. This policy differs quite substantially from the commitment of neighboring India to a socialist pattern. Despite this difference in proclaimed policy, Pakistan's economy has in the past been at least as tightly controlled and at least as much dominated by government as that of India.

Direct participation of the Pakistan Government is most pronounced in the development program. Seventy per cent of the expenditures under Pakistan's First Five Year Plan were to be channeled through the budgets of various government and semi-governmental organizations.[1] Some additional investment funds were to reach private investors through government lending institutions or other indirect means. The corresponding figures for India involve government expenditures (estimated actuals) of 55 per cent of total expenditures during her First Five Year Plan and of 67 per cent (planned) during the Second Five Year Plan.

In actual performance, private investment in India is running at a rate which is higher than planned while the opposite is true in Pakistan. In addition, the trend in Pakistan is towards a further increase in the proportion of government development expenditures. Private investment has decreased absolutely as government's capacity to execute development projects increased, as the private development of textiles slowed down, and as foreign exchange shortages became a problem. The decrease in private investment is largely the result of conscious government action in decreasing the allocation of foreign exchange for private investment. In 1951-52, for instance, private investment was estimated at about two-thirds of total development expenditures of 1,050 million rupees.[2] By 1954-55 development expenditures had increased to about 1,500 million rupees and estimated private investment had risen absolutely, but was only slightly over 50 per cent of the total. From then on estimated private investment declined absolutely.

The 30 per cent of investment which recently remained in private hands is also tightly controlled by the government. Most

[1] Government of Pakistan, *The First Five Year Plan,* Karachi, December 1957, p. 22.

[2] Estimates derived from data and calculations of the Planning Board, Government of Pakistan (unpublished).

investors have to obtain government permission to incorporate, to issue shares and to import. Almost any large-scale enterprise in Pakistan requires at least some imported goods, usually both for initial investment and for later operation. Therefore, import controls are extremely effective in influencing or determining private decisions on the size, location and scale of operation of plants, the raw materials to be used and output produced.

While the government's share of new investment in Pakistan is large, its share in past investment is small, as is the importance of its income and expenditures in the total current income of the country. The revenues of Central and Provincial governments are over 10 per cent of National Income. Government expenditures, greater than revenues largely because of foreign aid and government creation of money, are around 20 per cent of National Income. These figures are substantially smaller than in such countries as the United States where government revenues absorb about 30 per cent of National Income.

However, the government has powerful levers for influencing decisions even in the parts of the economy it does not directly control. Import controls have already been mentioned. These are reinforced in the case of industry by price fixing over a wide range of goods, some rationing, some controls over exports, labor legislation, building codes, and a host of other special powers. The government can largely determine the wages paid and the expenditures for other workers' benefits. It can provide electricity and other utilities, or withhold them. It can provide tax concessions, credit and direct equity participation in an enterprise. Non-industrial private economic activities are controlled by some of the same means, as well as by building codes and permits, route permits for transport companies, widespread powers to acquire land for government purposes, and detailed regulations in such fields as insurance. Substantial direct administrative powers and the importance of government (including defense) purchases, occasionally play a role in government control over economic affairs.

In the large and important rural sector, in service establishments and in small and cottage industry some economic decisions are made by many cultivators, artisans and entrepreneurs. But government exercises considerable influence even over these

establishments. It affects or determines many economic decisions of the farmer by setting the prices at which it purchases foodgrains (often compulsorily); by its procurement, storage and foodgrain import policies; by the export duties it sets on cotton and jute; as well as by subsidies for fertilizer and other goods which affect the cost of factors of production. The small industrial producer and artisan is similarly subject to government control or influence through restrictions on the import of raw materials and spare parts, the lending policies of various government credit institutions, government control over property left by those who have gone to India and government organized cooperatives or other institutions assisting with purchasing and marketing operations.

The full range of powers normally used by the Pakistan Government gives it a predominant influence over economic decisions. A concentration of economic power in government hands has occurred in many underdeveloped countries. It has been fostered by the absence of a substantial and established entrepreneurial group and the desire for a pace of development more rapid than the economy is thought capable of achieving without strong government intervention. This was undoubtedly reinforced in both Pakistan and India by the concentration of prestige, power and competence in the pre-Independence Civil Service. In Pakistan there probably is an even greater relative concentration of talent in the Public Service than in India. In prepartition India, Muslims did not have a proportionate share in business and the professions, but were assisted in their government career by a quota system.

Economic power is highly concentrated within government as well. Only a very limited influence on economic decisions is exercised at the local level by either government officials or by local government in cities, villages, and districts. The revenues of local government are small and not sufficient to maintain a minimum of standard services. Their dependence on funds from other levels of government in itself restricts their freedom of action. Their regulatory powers are equally limited, consisting largely of some building, zoning and licensing laws, often enforced very badly or effective only in the case of very small enterprises.

Local bodies are generally poorly staffed, have little prestige and are subject to a great deal of supervision by Provincial Governments and faced with the possibility of dismissal by them. As a result they are guided by the policies and decisions of Provincial Governments even in spheres of economic action theoretically within their powers. Central or Provincial government officials posted in the districts also have only extremely limited funds at their disposal. Their judicial, police and general administrative powers can be used to assist, hamper or influence particular economic activities to some extent, especially in labor relations, the control of illegal activities and the construction of local government projects. In general, however, they too are restricted to carrying out economic policies and decisions reached at a Provincial or Central Government level.

The role of Provincial Governments in economic affairs is a substantial one, but it is not nearly as extensive as the federal structure of the country and the division of responsibilities in the Constitution would lead one to suppose.[3]

Legally, responsibility for the bulk of government expenditures outside of defense seems to lie with the Provinces. With the exception of defense, a few industries and some transport undertakings, the Provinces are to carry on most governmental economic activities. But until now they have been unable to raise their own finances to carry out their functions. Provincial revenues have been largely or entirely required to maintain the government establishment and carry out its law and order functions. Funds for capital expenditure have had to come from the Central Government which has provided them only under the policies and for the purposes which it deemed sound. In effect, nearly all capital expenditures of the Provinces require Central Government approval before they are undertaken.

The reasons for the absence of Provincial financial independence are simple. First, all foreign loans and grants, which finance a good part of capital expenditures, flow through the Central Government. Secondly, of total national revenues the Central

[3] The relationship between Central and Provincial governments under the present government is not yet clear. However, there is little doubt that more centralization of policy formation is taking place and that the argument in the paper has been strengthened by the recent changes in Pakistan.

Government has collected about two-thirds and its share is increasing.[4]

The major reason for this lies in the revenue sources open to the respective governments. The Central Government controls most of those taxes which increase automatically and rapidly with economic development and rising prices (e.g. income, excise, corporation taxes) while the Provincial Governments depend on relatively static sources of revenue (e.g. a tax on agricultural land which is fixed for long periods). In addition some of the revenues of the Central Government are indirect taxes (such as excises, import and export duties) which can be increased with less danger of political reaction than the more direct and obvious taxes and charges which are a large part of Provincial revenues. The Central Government also seems to have shown somewhat more political courage in increasing tax rates or imposing new taxes. For instance, a major source of increased revenues for West Pakistan could have been an increase in irrigation charges, but successive governments have been extremely reluctant to raise these in proportion to the increase in the price level; one substantial increase made in the Punjab was actually withdrawn hurriedly after a short period. Finally, the Central Government, but not the Provinces, is able to resort to "deficit financing," that is printing money or borrowing it, largely from the State Bank.[5] Adding all of the financial sources of the Central and Provincial Governments, the former controls about 70 per cent of total government financial resources and thereby the bulk of Provincial expenditures which involve policy decisions—those which are not largely to cover routine administrative costs. In addition the Central Government controls the taxes which are subject to substantial modification. This gives it a further tool for influencing and controlling the economy through tax policy, which is largely denied to the Provinces.

[4] At the time of Independence the Central Government revenues totaled 692 million rupees, while Provincial Governments collected 490 million rupees. In the 1957-58 budget Central revenues had risen to 1343 rupees, an increase of nearly 100 per cent and Provincial revenues to 842 million rupees, an increase of about 70 per cent. (Government of Pakistan, *The First Five Year Plan*, pp. 143-144). In the 1958-59 budget the Central Government again increased revenues by much more than the Provinces.

[5] The amount of this has varied from year to year, but it may provide as much as 250-300 million rupees a year. (Government of Pakistan, the *First Five Year Plan*, p. 140.)

The second area of economic influence shared by Provincial and Central Governments is the establishment of general economic policies. Here the Central Government plays an overwhelming role, partly for inevitable or constitutional reasons, partly for historical ones. It naturally controls the money supply and with it the possibility of creating money. This alone assures the Central Government of a large degree of influence over the economy, including the price level, the rate and nature of investment and the distribution of income. It also controls banking, and thereby influences the nature, extent, and cost of credit. The Central Government is responsible for foreign trade, exercising control over total imports and some control over exports. It is also predominant in decisions on the allocation of foreign exchange among investment goods, raw materials and consumer goods and thereby largely determines the rate of total investment in the economy, as well as the rate at which existing industry can operate. Policy on foodgrain procurement, pricing and imports, is influenced or determined by the Central Government. Its larger and more experienced staff dealing with economic matters has also helped assure it a dominant role.

Quite naturally, Provincial Governments have the greatest influence with respect to economic decisions affecting particular enterprises or groups of enterprises, but even in this respect the Central Government has been dominant. The cooperation of the PIDC (Pakistan Industrial Development Corporation), a Central Government body, has been important or essential to a number of enterprises and its role in the development of the jute and other industries gave to the Central Government a key position in some important fields. More important, the licensing of foreign exchange even to particular firms, was largely controlled by the Central Government and continues to be greatly influenced by it even now. If complaints by individual entrepreneurs and Provincial Government officials are any indication, the Central Government continues to have a dominant voice even in decisions with respect to the establishment or operation of individual enterprises.

Whatever has been said about the relative weakness of the Provinces applies with particular force to East Pakistan. Its revenues especially have been inadequate in relation to expenditures

—the normal East Pakistan budget has been in deficit for a number of years—and its dependence on Central Government funds therefore much greater. The East Pakistan government has been in a weaker political and administrative position with less effective representation at the political level, fewer experienced Civil Servants and a longer period under direct Central Government control. East Pakistan does earn something more than half of Pakistan's foreign exchange and this resource could put the Province in a strong economic position. Control over foreign exchange is, however, largely with the Central Government and East Bengal's contribution of this resource gives it little or no additional economic strength. Bengalis have emphasized the inequity of having the Province's economic and political position weakened by its lack of internal resources without having it strengthened by its greater contribution of foreign exchange.

One other aspect of Provincial-Central Government financial relations is worth mentioning. Until the unification of West Pakistan, the Province of Sind was in the strongest position in the Western part of the country. While Baluchistan and the Frontier Province required assistance with their normal budgetary expenditures and the Punjab depended on the Central Government for most of its capital expenditures, Sind was financially largely independent. This undoubtedly strengthened its position on various economic and political issues, particularly its determination to use newly irrigated lands in the Province to settle Sindhis and not refugees or others.

While the relative economic power of various Provinces has differed, all of them have a minor role compared to the Central Government. Even within the Central Government these powers are highly concentrated. A number of Ministries, the State Bank, the Planning Board, the PIDC (Pakistan Industrial Development Corporation) and other semi-autonomous bodies are involved in economic decisions. Some of these agencies have considerable influence on particular economic issues. The PIDC for instance, determines the initial selection of its projects, the Commerce and Industry Ministries select recipients of individual import licenses, and the Planning Board is in a position to offer advice on a wide variety of issues. A discussion of the functions and relative influence of Central Government agencies is beyond the scope of

this paper.[6] But it is essential to recognize that on nearly all economic issues the weightiest voice and much of the final decision are with the Ministry of Finance, whenever it cares to exercise its power, which is frequently. Of course the officials of that Ministry are influenced by the views of other officials, and the Finance Minister takes account of the views of his colleagues and particularly the Prime Minister. The Finance Ministry naturally is also subject to Cabinet decisions. All of these checks, however, operate only partly and intermittently. The Finance Ministry directly decides many economic issues. On other issues its views are given great and often decisive weight.

Given the nature of government in Pakistan,[7] decisions of any importance are concentrated in the hands of a few government officials and Ministers. It has been suggested that economic power rests primarily with the Central Government and especially its Ministry of Finance. As a result, an extraordinary share of major economic decisions is in the hands of a very small number of individuals in that Ministry, nearly all of them civil servants.

Before leaving the discussion of the role of government, something needs to be said about the importance of foreign resources, (loans, grants and investment) and the agencies providing them. These resources are crucial economically and certainly significant politically. The inflow of foreign aid and loans has been at a rate of $200 million a year, without taking account of direct military assistance. The annual rate and use of these funds is obviously of great significance when measured against Pakistan's receipts from exports or invisible earnings of around $400 million, and its expenditure of some $200 million of foreign exchange on development.

The bulk of foreign resources has come from the United States. Nearly half of all such resources were in the form of grants and loans from the United States Government for development and other foreign exchange needs. About another quarter has come in the form of United States agricultural commodities. The remaining quarter or so includes World Bank loans, assistance from

[6] These functions may also be changing, as the result of recent government reorganizations but the nature of such changes are by no means established late in 1958.

[7] *Cf.* Keith Callard, *Pakistan, A Political Study* (London, 1957).

Canada and other countries under the Colombo Plan and foreign private investment, very largely in oil and gas exploration.

The relative importance of this inflow of foreign funds raises three major issues with strong political implications—the effect on the economy, should there be a substantial increase or decrease in the amount of funds available; the effect of these funds on Pakistan government policies; and their effect on political life and public opinion. Some aspects of these issues are touched on later in this paper, but most are beyond its scope. To do justice, for instance, to the role of United States Government loans and grants in Pakistan–United States relations would require a paper in itself.

The concentration of economic power within the Government has its counterpart in the private sector. It is most pronounced in the case of modern industry. Muslims had played a relatively small role in the industrial life of pre-Partition India. There was, therefore, no substantial group of industrialists in Pakistan or who came to Pakistan at Partition. A few families with some industrial background and wealth—like the Adamjees—were in a position to assume a dominant role in the rapid industrialization that followed Independence. They were joined by a few others who took advantage of favorable circumstances during the early years after Independence to establish an industrial position. These families—like the Saigols—developed their industrial holdings at a time when foreign exchange to buy machinery was available as a result of the Korean boom and large profits were made and could be reinvested as imports were sharply curtailed at the end of that boom. Some of the families expanded very modest holdings into dominant industrial empires in the process. Other families entered modern industry at a later stage. They found themselves handicapped by difficulties in obtaining foreign exchange for expansion and by sharply declining profit rates, as domestic production in many lines began to satisfy domestic demand. As a result there are perhaps a dozen or so industrial groups—practically all of them based on particular families—that dominate the modern industry sector of the Pakistan economy.

The sector of small scale and cottage industry is almost inevitably one of many small independent firms. It shows very little concentration of economic power, but its influence on many

economic magnitudes has declined and continues to decline, as it is forced to adapt its prices and procedures to the standards set by the factories.

An elaborate structure of labor legislation and trade union organization exists and might be expected to limit the power of industrialists. However, legislation has been very haphazardly and inadequately enforced and trade unions are very weak, both politically and economically. Trade union organization remains rudimentary as the result of the pressure of substantial unemployment and underemployment, the inadequate leadership, mostly drawn from outside groups often interested in political advantage rather than union strength, and the strong opposition of many industrialists and government officials.

Economic power is more diffused in trade and commerce, perhaps largely because there were substantial numbers of Muslims with a background in these fields, both in the area that became Pakistan and among refugees. In addition, various government regulations tend to prevent consolidation and concentration in some sectors of trade. The most important are import controls, which rather rigidly divide the total business to be done among existing firms on a historical basis, assuring each of sufficient profits to continue operation while preventing the more efficient firms from expanding at the expense of the less efficient.

It is in commerce and trade, however, that business communities play an important role.[8] Business communities, which exist in India as well, are generally based on religious or geographic foundations. Their members are overwhelmingly in some form of commerce or trade, though a number also play a role in industry and the professions. In Pakistan some trades are dominated by a particular business community. For instance, the Memons are estimated to control 90 per cent of West Pakistan's trade with East Pakistan and 60 per cent of foreign imports into Karachi and Chittagong, while in Karachi the Bohras are dominant in the hardware, timber and paper businesses, and Khoja Ismailis are important in watch imports, spices, leather goods and the ownership of "ration shops," handling stable foodstuffs. Within communities, individuals cooperate more or less closely, but in all

[8] The following discussion of business communities is based on "The Khoja Ismaili Community of Karachi," by Hanna Papanek, (unpublished manuscript).

communities members generally prefer to deal with each other and may assist each other. Some communities organize joint facilities for credit, banking and insurance, as well as machinery for settling disputes. Individual enterprises of community members are operated independently and there is little evidence of any attempts to use the business communities either as a vehicle for forming cartels or for the domination of a trade by a few community leaders. However, community leaders are able to exercise some influence on business decisions in their community. They are often leading figures in the credit and other economic organizations of the community, which may reinforce their influence over business decisions of members who take advantage of these organizations.

Contrary to usual beliefs there is no great concentration of economic power in agriculture for Pakistan as a whole, although there are some geographic areas where this is not the case. In East Pakistan, where large landlords were generally Hindus, Partition brought with it the exodus of a number of this group. Landlords in any case had played less of a role in Bengal politics than in other Provinces and with the departure of some and the greatly decreased political influence of the remaining Hindu landlords, far-reaching land reform legislation could be passed. In its implementation most of the large landowners in East Pakistan are disappearing and economic power in East Pakistan agriculture will increasingly be diffused among a large number of small and medium-sized cultivators.

In West Pakistan considerable concentration of land ownership exists in some areas. Available data are fragmentary, not too reliable, and outdated. They indicate that before Partition in the Punjab about one-half of one per cent of the owners held about 21 per cent of the land, that in Sind 3 per cent of the owners held nearly one-half of all the land (124 owners held one-eighth of all the land in that Province) and there was considerable concentration in the former North West Frontier Province.[9] Since the number of large Hindu landlords was not too great in these areas, these figures are probably indicative of the present situation.

Given the importance of landlords in the West Pakistan legislatures, no effective steps have so far been taken to change the

[9] Government of Pakistan, *The First Five Year Plan* (Karachi, pp. 308-309).

tenure system and none seem in prospect.[10] But even now the proportion of land in the hands of large landlords is sufficiently small to justify the contention that economic power in agriculture as a whole is relatively diffused. In the Punjab three-quarters of all land was in the hands of owners with less than 100 acres, and landlords controlling 500 acres or more owned only 10 per cent of total acreage. With concentration of land ownership even less in East Pakistan, the two dominant agricultural areas do not exhibit an excessive degree of concentrated power over economic policy decision. However, the large landlords have continued to be a major political force in West Pakistan, where they dominate the legislature. Government economic policy in that province has been influenced to some extent by the interests of large landlords, but their effectiveness has been primarily negative, largely restricted to preventing any land tenure changes.

Politics and Economic Policy Decisions

The picture painted above of the location of economic power and decisions has shown a large degree of concentration. The role of government is a dominant one despite Pakistan's policy of encouraging free enterprise. Within the Government, power is concentrated in the Central Government and much of it is exercised by a few government officials in the Ministry of Finance. Economic power in modern industry, the most dynamic sector of the economy, is concentrated in the hands of a few families. Commerce and trade is carried out with much less concentration as far as individuals or families are concerned, although a few business communities dominate some lines. In some parts of West Pakistan agricultural land is owned in large units and economic life dominated by a relatively few families. But in the rest of the country, economic power in agriculture is shared among a large number of individuals.

The discussion so far has not dealt with popular concern and participation in economic policy decisions. The following section briefly examines this question.

There are several factors in Pakistan which might be expected to result in relatively more widespread attention to economic

[10] This again is likely to change to some extent as the result of recent government changes.

issues than in similar countries. As in many other underdeveloped countries, incomes are low and unequally distributed. In addition most Pakistanis are subject to frequent and substantial changes in income as a result of the very heavy dependence of the economy on an agriculture based on an erratic monsoon. They might be expected to look to political action and the government for changes in income distribution and protection against economic fluctuations. At the same time political action is believed to be, and indeed is a more effective means for influencing economic issues than in countries where the government's part in economic affairs is a more modest one.[11]

In addition, large groups have strong economic grievances which are more easily redressed by poltical than economic means. Tenants, landless laborers and small cultivators, who want a change in their status can not exert much economic pressure as long as there is a continuing shortage of cultivable land. The power of factory labor to improve working conditions by economic pressure is similarly limited by the large pool of underemployed and unemployed labor. Such groups as clerks, lawyers and high school and college graduates with a general education often find that they cannot be effectively absorbed by the economy. Refugees from India are another group that frequently finds it difficult to obtain suitable employment. All of these groups might find political action useful in improving their position.

Finally there are a number of geographic areas that are less developed in relation to the country as a whole. The largest of these is East Pakistan, but substantial areas of West Pakistan feel equally disadvantaged. They have only limited ability to develop more rapidly using the resources now available to them. Several of these areas are at the same time convinced that their economic backwardness is partly or largely the result of discrimination. This would be all the more reason for trying to redress economic grievances by using their strong political position.

Despite the factors discussed, economic issues have so far played a surprisingly small role in public political life and been

[11] Economic development which should be of particular concern in a country that is both underdeveloped and suffering from the after-effects of partition, is one of the economic issues considered almost exclusively a government problem.

of little popular concern in Pakistan. Only the charge of economic discrimination against East Pakistan has been given frequent and substantial attention in the press, legislative debates, political speeches, and in demonstrations of various kinds. Even in this case, economic grievances were only a part of a complex amalgam of issues.

Except for the economic component of East Pakistan grievances there has been little concern with economic issues. The dispute with India, for instance, centers mainly around Kashmir, and not around the water dispute and evacuee property, which have great importance for Pakistan's economic future. Pakistan's relations with other countries are also dominated by the question of Kashmir. Adherence to the Baghdad and SEATO pacts has aroused more political controversy than the nature of foreign assistance, despite the latter's importance to Pakistan's economic stability and controversial nature in other countries. Internally, the issues that have exercised people have been those of religion, language and local autonomy. Even when West Pakistan was threatened with a severe food shortage, that problem was often overshadowed by the dispute over the establishment of a single Provincial Government for that area. The obvious and immediately important issue of inadequate food supplies and high prices, a not very rare occurrence, has sparked fewer serious demonstrations or riots than language, religion, foreign policy, regional autonomy and other noneconomic issues.

An examination of the reasons for this relative lack of public concern with economic issues is beyond the scope of this paper. Undoubtedly one important factor is the inexperience of politicians, accustomed to concentrating on anti-colonialism, and the inexperience of the electorate who are not yet fully aware of their own power to affect government decisions. This is compounded by the absence of any national elections. In addition Pakistan has for some time lacked effective and stable political leadership of national stature and continuing influence. In its absence the necessary simplification, explanation and presentation of complex economic problems and the means for their solution could be done only inadequately. At the same time there has been little security of tenure for the individual politician or government, since the assassination of Liaquat Ali Khan. This may

have made it seem unrewarding to deal with economic problems, often requiring steps that cause short-run unpopularity while producing popular results only when other politicians will be in power to reap the rewards. To examine these and other aspects of Pakistan's political life would be a very worthwhile, but separate undertaking.

Some Effects of the Location of Economic Power

Several characteristics of the location of economic power in Pakistan have been described above, the importance of government, the particular importance of the Central Government and of civil servants, the relative concentration of the power remaining in private hands, and the relative lack of popular concern with or participation in economic policy decisions. These factors have affected many of the decisions on economic policy and are, in turn affected by them. Some of these effects are briefly discussed below.

The distribution of power affects first the allocation of resources. Quite naturally organizations in a position to decide the allocation of scarce resources generally assure that their own requirements are met first. It has been widely accepted that this has meant in Pakistan that government needs are often met at the expense of private requirements and that Central Government needs are met before those of the Provinces. Figures cited earlier showed private investment as a share of total development expenditures declining from about two-thirds to around one-quarter over seven years. Year to year fluctuations have been quite sharp as well, as private investment often is treated largely as the residual claimant on foreign exchange, to receive whatever is left after government has met its own requirements. Within the government, Provincial needs often receive lower priority than those of the Central Government. Local bodies are similarly starved by the Provinces.

This pattern of allocating available resources has the advantage of concentrating them in the hands of the Central Government, which is often best equipped with manpower to use them efficiently. At the same time it makes decentralization of decision-making difficult or even impossible. It is widely accepted that a

high degree of decentralization would be desirable in view of the inadequate number of administrators and managers, difficult communications, and the variety of new and different problems in different parts of the country. Yet the inability of private entrepreneurs, local bodies and Provincial governments to obtain the resources required means that they often cannot play as large a role as they would be capable of doing.

Another effect of the centralized economic system of Pakistan, with power and resources concentrated in a relatively few hands in the Central Government, is to make it sometimes difficult to deal with particular pressure groups. The groups applying pressure on the government may be less well organized than in other countries, but there rarely is any balancing pressure or support from other groups concerned with a broader national interest. The absence of a national electorate, of truly national parties and of almost any effective nationally organized bodies has meant the weakening of pressures from outside the government for the safe-guarding of national interests against the demands of particular interests.

Particular interests in Pakistan, as elsewhere, take many forms. Within the government there are strong departments or agencies —the railways, the PIDC—more effective than other agencies in pursuing their own programs. There are particular geographic areas, cities, and villages, landlords, industrialists, businessmen, professors and other individuals and group exerting pressure for economic decisions favorable to their interests. None of this is unusual. The importance of the government's role in Pakistan increases the importance of its decisions. In the absence of a national electorate, effective national parties and concern with economic decisions in public life, the national interest depends very largely on the wisdom and strength of the particular individual or few people who make government economic policy in a particular instance.[12]

Two examples provide some evidence on this: land tenure change and the problem of government officials' impartiality and honesty. West Pakistan landlords strongly oppose any substantial change in the land tenure system. Some government officials feel

[12] There is, of course, no intention to imply that particular interests are always opposed to national interests. Often they are not, but sometimes they are and it is the latter instance that is of concern here.

equally strongly that radical changes are necessary to healthy political growth in Pakistan. There is little evidence that such groups as the industrial and commercial classes have any strong and consistent feelings about this issue. Whatever sentiment for change exists in the civil service has been ineffective in this case without backing by public opinion, national political parties or leaders. In India the large landlords are probably no more enlightened and the civil service no more effective on land reform, but there are political parties and leaders capable of articulating and organizing dissatisfaction with the present tenure system and regular elections to channel pressure for its change. As a result, land tenure relations have changed substantially in all parts of India in relatively few years.

Cases of the unchallenged expenditure of funds to benefit particular areas and the lack of constant strong action against government officials accused of taking improper advantage of their position are difficult to document. However, stories about decisions made to benefit a particular government employee or his friends or a particular area are quite current in Pakistan. Some of these decisions would have little significance for the economy as a whole, although they would fundamentally alter the economy of the person involved. Others, involving the establishment of new enterprises, their location or the grant of import licenses for raw materials, are of more general importance. Perhaps most important are cases where pressure from particular local politicians or others for roads, dispensaries or other tangible evidence of influence has been acceded to by the government officials. Citation of these reported cases does not imply that civil servants in Pakistan are more subject to corroption or pressure than elsewhere. Actually, their ethical standards are probably at least as high as those of most civil services. The point is only that in Pakistan, as in some other countries, too much depends on these standards, since neither public concern nor national political leadership provides much of an independent check against personally or locally motivated decisions.

A corollary of the weakness of organized general popular or political pressure is the greater scope for a few strong-minded government officials and political leaders to carry out policies which are likely to be widely unpopular. Policies which do not

require active support, but only acquiescence and the absence of organized opposition, can be carried out more readily when there are few or no organizations which can effectively represent the large and diffuse interests that are adversely affected. Examples that can be cited are general tax increases and increased food-grain prices.

In 1958 the Central Government increased its total tax collection by over 10 per cent. This was a year in which elections were expected to take place, but even in an ordinary year a 10 per cent tax increase would be an unusual and courageous step in any country. It is at least doubtful that such a drastic tax increase would have been possible in a country where the inevitable protest would have found more effective and organized expression.[13] In East Pakistan a much less drastic tax increase was not possible while the government was in the hands of elected Ministers. When this government was temporarily replaced by one under the control of civil servants, a number of painful tax measures, under discussion for months, were quickly put into effect.

Foodgrain prices have for some time been subsidized in Pakistan. At various times economists and others have urged a decrease or abolition of those subsidies. The subsidies were in fact reduced, most markedly in 1958. As in the case of Central Government tax increases, the decision to do so was made by a few civil servants and political leaders.

These and other unpopular policies would have been accompanied in other countries by steps to develop public support or acquiescence, if they were taken at all. In Pakistan no such steps were necessary. The centralization of power over economic decision, and especially the absence of organized popular participation, made it possible to carry out needed but difficult policies when a few government officials and political leaders were sufficiently determined to proceed with them.

The examples discussed above involved policies which civil servants would normally be anxious to implement and that required only acquiescence by most of the population. There are some other government programs requiring widespread support and participation which may be more difficult to carry out under

[13] Tax increases in neighboring India have been less drastic in any year, but more consistent over the long run. At least one tax increase was postponed until after an election had taken place.

Pakistan circumstances. For a number of reasons an economic development program is a good example of this category.

The weakness of popular pressure and the centralization of decision-making which facilitates imposition of taxes, can also weaken the drive for development. Government officials in Pakistan are no less committed intellectually than those of other countries to a large development program. But resources everywhere are limited and strong pressures exist for competing claims. Everywhere the civil service itself presses for higher government salaries and more staff, the military for expansion of the defense forces, and other groups for their share of resources. Development requires not only resources, it requires changes in organizations, institutions and policies. Such changes are difficult to make. The pressure for diverting resources to development and for making the changes required for development can come from political parties, or other organized groups representing the population in general. Given the general weakness of popular participation in government economic policy-making in Pakistan there is little effective pressure on the few government officials, who are largely responsible for development policies, to expand the scope or increase the effectiveness of development.

Programs like economic development require not only a decision by goverment, they also require enlisting the positive participation of much of the population. Various community development programs, programs to disseminate improved technology, organize cooperatives and increase private savings, are just some of the crucial components of economic development which depend on widespread participation. Civil servants, especially in former colonies, very often are not accustomed to enlisting this participation, but expect to accomplish their objectives by issuing orders. Even where government officials overcome a natural inclination to issue orders, they often find it difficult to enlist popular cooperation. Organizing a vast voluntary effort, encouraging popular participation, eliciting enthusiasm are all tasks which a civil servant, particularly one trained in a colonial tradition, often performs less effectively than a politician.

A brief comparison of the development programs of Pakistan and India might throw some light on the effects of the greater

centralization and smaller popular participation in economic decisions in Pakistan. Such a comparison is difficult to make, since India's resource endowment is far greater, her problems resulting from Partition much less, her defense effort smaller proportionately and her receipt of foreign resources smaller as well. However, the trends in development expenditure and the methods of financing development may throw some light on the effects of a different government organization.

Comparisons are limited by the availability of data, but the following rough percentages of national income are characteristic.

Development Expenditures as a Percentage of National Income

	Government Development		Private Investment Annual Average
	1951-52	1958-59 (budget)	1951-52 to 1955-56
Pakistan	2.2	7.5	3.2
India	2.8	9.5	3.5

Pakistan's record in increasing governmental development expenditures between three and four times in seven years is a creditable one in view of the effects of Partition, the lack of resources, and the defense burden. The disparity between the two countries is much smaller than is often believed. There are three interesting differences between them, however. One is the increase over time in the margin of difference of the development expenditures. Secondly, Pakistan spends about 5 per cent of its national income on defense, India about half as much. If this is added to development expenditures both countries divert about the same percentage of their national income to these two non-consumption uses. Finally, there is the fact that foreign loans, grants, and investment are equal to perhaps 10-20 per cent of India's development effort, while in Pakistan they equal about 50 per cent of the development effort. In other words, India has been able to raise from its own resources a much higher proportion of the wherewithal required to sustain development.

These somewhat sketchy comparisons of development programs in India and Pakistan are suggestive only. But at least they do not contradict the argument advanced above that a centralized

system with less general participation is able to be quite effective in carrying out policies which require only popular acquiescence, such as diversion of resources from consumption to investment and defense, and the carrying out of a development program which involves heavy expenditures and a corresponding administrative burden. Such a system would encounter more difficulty with policies that require organized popular support, pressure and participation such as assuring that an increasing share of the national income is made available to development and that an increasing development program is effectively carried out.

Summary

The major issues considered in this paper can now be briefly summarized.

The power to affect over-all economic magnitudes is highly concentrated in Pakistan. Although there are several factors that might make for considerable popular concern with, and participation in, economic policy decisions, this participation has not taken place. Government plays a dominant role in major economic decisions. Economic policy decisions are concentrated in the Central Government and in the hands of a few people in its Ministry of Finance. In modern industry, economic power is concentrated in the hands of the relatively few families that took advantage of favorable conditions in the early years of Pakistan. Trade and commerce is more decentralized, although particular business communities play a dominant role in some lines. There is a considerable degree of concentration of land ownership in parts of West Pakistan, but for the country as a whole economic power in agriculture is relatively diffused.

As a result of the concentration of economic power and the absence of organized general participation in the making of economic policy it may have been easier to carry out a number of unpopular policies, not requiring active popular support or participation. On the other hand pressures by particular groups have been more difficult to resist and programs requiring popular support and participation suffered. The latter tendency may have been of special relevance to the size, growth and nature of the development program.

TOWARD POLITICAL STABILITY IN UNDERDEVELOPED COUNTRIES: THE CASE OF INDIA

Lloyd I. Rudolph and Susanne Hoeber Rudolph

RECENT events in underdeveloped countries have confronted statesmen and social scientists with a classic problem of politics, political stability. The first task of government is to govern. The rulers of some underdeveloped countries have found it difficult to discharge even this minimum responsibility within a constitutional democratic setting. Others, while able to maintain conditions of order within such a setting, have failed to meet the primary test of effectiveness, economic development.

Because of these difficulties, constitutional democracy is faltering in many underdeveloped countries; in others it has been scrapped with little prospect that it will be restored in the foreseeable future. Indonesia is still trying to regain its equilibrium after a small scale civil war. In Burma, U Nu invited his Chief of Staff, General Ne Win, to form an "interim" government. Thailand, Pakistan, the Sudan and Iraq have scrapped their constitutions, party systems, and elections for an authoritarian military regimes. Generals Sarit Thanarat, Ayub Khan, Ibrahim Abboud, and Karim Kassem have made the vaguest kinds of remarks concerning an indefinite future time when a constitutional order and popular participation in political life may be restored. For the moment they are concerned with order and administrative efficiency. In still other underdeveloped countries, particularly in those without a colonial experience, constitutional democratic government has never been tried. Authoritarian regimes are the order of the day, and they, too, have been subject to abrupt shifts in power.

In the midst of these troubles, India has retained a large measure of political stability. It has retained a government capable of framing policies that bear a rational relation to the felt and anticipated needs of the country, of organizing the means to effect these policies, and of providing policy and administrative continuity. This political stability rests firmly on democratic authority which has been tested in two general elections.

What lies behind the obvious facts of Nehru's strong leadership and the Congress Party's ability to mobilize a parliamentary majority? The answer to this question is relevant not only to the Indian case. In so far as the Indian experience has something in common with that of other underdeveloped countries, the analysis can contribute to an understanding of the factors which promote political stability in a democratic setting. The four factors that seem most relevant are: the nature of the colonial experience; the characteristics of respective nationalisms; the structure and role of the agricultural classes; and the capacity for effective political organization and leadership in the mass electorate.

The Effects of Colonialism on Political Stability

In many nations of Asia and Africa colonial rule either initiated or contributed to the disintegration of the traditional culture by fostering modern social, economic and political values and methods. Since, under the conditions of world communications prevailing today, such changes are virtually inevitable, it may be useful to inquire how effective an agent of cultural change colonialism has been. Is change under the aegis of a colonial regime more apt to create conditions for subsequent stable politics than change without the benefit of colonialism? The spectrum of uncolonized Asian countries is not very wide. It includes on the one hand Afghanistan, Thailand, and Iran, probably in that order, which have been only marginally effected by modernization and whose narrowly based governments are not notably stable; and Turkey and Japan at the other end, both of them as modern and stable as any state in Asia. It might be argued that what Iran and Thailand and Afghanistan needed was a thorough colonial experience, but the Turkish and Japanese examples recall that colonialism is not essential to successful change.[1]

In view of the fact that most Asian countries did have some experience with colonialism and that these differing experiences were associated with a variety of results, the type of colonial experience involved becomes an important variable in the anal-

[1] In a sense, Japan was colonialized in the period of American Military Government. In the area of political acculturation, this experience may have been crucial if not decisive.

ysis of change and stability. Colonialism inevitably introduced some change, and usually at a faster pace than would have been the case without it, with the result that it had some disintegrative impact on the traditional society and institutions. The pace of disintegration, the areas affected, and the success with which alternative values and institutions were developed depend in large measure on the type of colonialism experienced.

In some areas, where colonialism had a brief and superficial lifespan, it began or accelerated the process of disintegrating old institutions without adding to the institutional and cultural heritage for coping with the new situation. The ephemeral colonialisms of the Middle East tend to fall into this category. It may be argued that under modern communications conditions, these dislocations would in any case have occurred eventually. But because colonialism was the occasion for dislocation, and provided few compensating means for social and political re-integration, such areas have a ready-made scape-goat. The scape-goat frame of mind can only contribute to a lack of realism in coping with problems. Ephemeral colonialism must be counted among the factors which hinder the growth of political stability.

Ephemeral colonialism may be contrasted with a more enduring colonialism in which the colonial power is prepared to take considerable responsibility for cultural and institutional change. The more enduring colonialism again have taken at least two paths, indirect and direct rule. Some have argued that the cautious and gradual transformation of indirect rule, in which the colonial power operated largely through traditional institutions, represents the best solution to the problem of effective and stable acculturation. The cultural shock is well cushioned, men are not abruptly and harshly unravelled from accustomed ways, and they have time to adjust to new things. The various types of indirect rule practiced in Indonesia and certain areas of Africa exemplify this approach. It would deplore the rapid transformation of traditional institutions and values and the attempt to replace them by new ones. A judicious reliance on the traditional culture, it is argued, promotes political stability by never "bringing along" the colonial peoples at a pace more rapid than their state of "preparedness" warrants.

The policy often has the effect of maintaining the forms of the

traditional culture without its substance. Modern values are apt to exist side by side with traditional values, usually in conflict with them, and without institutional means for their expression or accommodation. Political instability is often the result when stability was the goal. Indonesia probably represents a version of this problem.

A third possibility is an enduring colonialism in which the colonizing power, not inhibited by an overly fastidious concern for traditional culture, proceeds over a long period to introduce new values, methods and institutions. India corresponds most nearly to this third possibility. Many of the cultural and institutional features which characterized India at independence were a product of the unselfconsciously ethnocentric and self-righteous Victorian impact. The Victorian conscience shouldered its responsibility of bringing light to the benighted with equal fervor whether the benighted were the lower classes at home or the Hindus abroad. The result in India was to build a broad and relatively deep westernized cultural base able to give vitality and effectiveness to the new political, administrative and legal forms.

More specifically, the duration of effective British control in India was 150 to 175 years. Rule was direct in about three-fifths of India—that is, Englishmen actually occupied the central and provincial seats of authority. In the about two-fifths of India occupied by the Princely States, government was a very diluted version of indirect rule. Britain's role was summarized in the term paramount power, and the relationship left the Princes internal autonomy while depriving them of control over foreign policy, defense and communications. With the possible exception of Baroda, Mysore, and Travancore, the directly administered provinces of British India came into the modern world sooner and more fully than did the Princely States.

In the area of economic change, British penetration conducted under the banner of free-trade undermined or modified the traditional economy. The new legal system struck at the traditional institutions and methods for settling disputes. The new centralized administration at both provincial and national levels to a large extent superseded traditional local governments. The availability of modern means of transportation and communication

created new areas of economic and political relevance, and provided the conditions for the broadening and transformation of traditional communities and the emergence of new, voluntary ones. The orientation of education on western models and the demand for new skills required for the new occupations altered the traditional social structure by counter-poising new achievement norms and occupational statuses to the traditional ascriptive system. And the impact of innovation was cumulative, producing modernizing effects even beyond the range of specific changes introduced by the colonial power.

These developments have their counterparts of course in many other colonial areas. The question is, to what extent was the dislocation accompanying a partial or total supercession of an old pattern paralleled by the successful transformation of the traditional culture and the development of a more purely modern culture to meet the new needs.

The effects of British colonialism on India probably produced their most negative results in the economy. The creation of a national communications network and the unification and rationalization of the legal and administrative systems laid the basis for a modern commercial and industrial economy, opening up the possibility of large markets. But apart from this important promotion of overhead capital, the free trade point of view which dominated this period was not favorable to the replacement of old economic institutions by new. It did not favor economic engineering by the state. The forces of the indigenous economy, which rested heavily on handicraft self-sufficiency, were badly damaged while local entrepreneurship, for reasons of psychological outlook, financial resources and competitive disadvantage among others, was unable to turn the new conditions to India's advantage. The relative weakness of technical, scientific, and managerial training in the new educational institutions meant that when independence came and the state was prepared to play a role in the economy, India was deficient in these key areas.[2]

While Victorian Englishmen believed in free trade and *laissez faire*, they were prepared to intervene in the legal, political and

[2] This argument is not meant to imply that England is necessarily responsible for India's current economic ailments.

educational realms. The English style liberal education introduced in 1835 created generations committed to an entire set of new values. These men were intellectually and psychologically prepared to work within the new legal, administrative and social systems. Numerous generations of Indians, in being educated for administrative and legal careers, absorbed the universalistic, impartial ethic of liberalism. As judges, lawyers, magistrates and administrators, they have applied these norms in their work, acting as agents of the new culture to the old. From the late nineteenth century, Indians sat in municipal, provincial and national legislative bodies, gaining experience and fostering a commitment to this form of decision and authority which was not merely ritualistic. In the Indian Civil Service and lower levels of the civil service, Indians gained a sense of standards, an appreciation that results require sustained, careful effort as well as words and ideas, and confidence and experience, all of which were turned to good use in the post-independence era.

It is quite possible that these results could not have been achieved by a colonialism less convinced of its infallibility. This is no argument that a Kiplingesque colonialism will cure the problems of today; it has become impossible under modern conditions. But it gave India a rather unique advantage among underdeveloped areas. Over one hundred years of western style education, and fifty years of experience with western norms and methods in administrative, legal and parliamentary activities, created a class of Indians with a deep understanding and commitment to them. There is probably no other underdeveloped area today with so large a class of nationals committed to these values. And while this segment of Indian society represents only a relatively small elite, it does provide an important force for political stability.

But it must be observed that while the acculturation process was well advanced at independence, it had deeply affected only the educated upper middle class. Had this been the only result of colonial rule, it is unlikely that the Indian experience after independence would have been as successful as it has been to date. However, colonialism also generated nationalism, and the specific form Indian nationalism took also made a vital contribution to political stability.

The Effects of Nationalism on Political Stability

If the innovations of colonialism were thoroughly meaningful only to the westernized elite, the contributions of nationalism went very much deeper. Nationalism after 1920 became a mass movement in India. It penetrated to the roots of Indian society. This does not mean that it succeeded in making modern culture meaningful to all Indians. But it did enable the westernized elite to communicate with the masses and laid the basis for reciprocal relations between the developed and the underdeveloped in India. Gandhian nationalism linked India's "two nations" by creating a sense of national community. While this sense of national community is still fragile, the gulf between modernized elites and the inarticulate masses so characteristic of underdeveloped nations today was bridged, however precariously. The elite and the masses found a cultural and organizational common ground which enabled them to act together. It is this capacity for common action which is crucial for stable politics under constitutional democratic conditions.

Popular nationalism is Gandhi's creation. He transformed the rather tame and select nationalism of the pre-1920's, broadening its class base and changing its ideological content. Pre-Gandhian nationalism relied on the products of the new educational system, the trouser-wearing, English-speaking upper-middle classes. For the most part, they were drawn from the upper castes and the new professions. These were the Liberals of the early nationalist movement. Their values were essentially those of the British middle class of the period, a comfortable bourgeois property orientation, combined with devotion to constitutionalism and moderate democratization of politics. Urban in outlook, they believed that western technological innovations and social and political reform eventually would create a stable, modern society with economic plenty. Their methods and outlook were loyalist: changes were to be realized only through constitutional means, and specific demands were couched in phrases replete with expressions of loyalty to the crown. Their appeal was to the city and not the countryside, to the educated, not the illiterate. They ignored the village and the village ignored them.

After 1920, all this changed. Gandhi emerged as the dominant figure in the nationalist movement. Under his influence, the

ranks of the prosperous, westernized, upper-class and upper-caste professional men were supplemented by leaders from the more traditional culture, often from lesser castes and callings. Many had town or rural backgrounds. With little or no western education, they continued to value the old ways and to look with a sceptical eye at the appeals of modernity. They responded to Gandhi's vision of simple, self-sufficient and autonomous village life, guided by a purified version of the traditional culture. Like Gandhi, they preferred the *dhoti* and the local tongue to the trouser and English speech. Gandhi personified the ancient tradition of the wandering ascetic who, through a personal struggle for self-mastery, won the merit which allowed him to teach others. He was the great teacher, the *guru*, a charismatic figure who interpreted and transformed elements in the traditional culture and fused them with some of the values and methods of democracy. After Gandhi, the Congress was no longer loyalist. From constitutional agitation it turned to *satyagrahas*, passive disobedience or non-violent non-cooperation, a method which had traditional appeal but which was tactically effective as well.

Over time, some of the older generation of Liberals, like Motilal Nehru, and other highly westernized leaders like his son Jawaharlal, embraced these new values at least as a matter of strategy, if not of conviction. Gandhi's appeal, his language, style, and methods infused nationalism with a new spirit, a spirit which was able to speak to those still steeped in the traditional culture. This was something which the earlier nationalism of the Liberals was neither able nor willing to do.

On the one hand, Gandhi taught Congress how to gain the popular support needed in an era when authority is expected to rest on a democratic mandate. On the other hand, because he has become a national legend, a folk hero, and virtually a part of the religious tradition, Congress benefits from a kind of inherited charismatic authority. Indian nationalism was distinguished by the successful fusing of old and new methods and values into a mass movement which not only spoke in the name of the nation but also commanded its active participation.

Gandhian nationalism contrasts sharply with many other nationalisms in another important respect. It succeeded in being self-critical and positive. Like Nehru today, Gandhi constantly

reminded his country-men of their failings, castigating the evils of caste, or social apathy, or religious intolerance, appealing to India to cleanse herself of her weaknesses that she might deserve the freedom which nationalism demanded. His approach united the western elite and his own more traditional followers in a spirit of self-criticism which created the climate for a more positive approach to India's difficulties. In an age when nationalisms are increasingly attributing the causes of deep-seated social, economic, and political problems to the ghosts of colonialism and imperialism and sustaining a sense of national unity through hatred of others, India's nationalism, while far from free of such tendencies, retains much of the self-critical spirit.

The transformation of Indian nationalism into a popular and tradition-tinged movement was not an unmixed blessing. Such a nationalism might have been expected to create demands for economic and social reforms beyond the capacity of India's resources; to precipitate a traditional reaction, a kind of fundamentalism which would threaten to stamp out modern culture and its bearers; or to make manifest latent divisions in the society.

In appealing to the peasant, Gandhian nationalism did exploit peasant grievances. But it explicitly avoided raising exceptional demands, restricting itself to the goal of justice within the existing pattern. For example, Gandhi called for lower rents and greater remissions of rent in bad crop years. In so far as land reform was an issue, it was to come about through individual moral regeneration followed by voluntary land gifts. Revolution of the soul, not of the social system, was encouraged. Under Gandhi, stimulation of "unrealistic" economic demands was certainly not a danger. There was, to be sure, the usual let-down when Indians discovered that Utopia and independence were not the same. But on the whole, influenced by the Gandhian conception of individual moral regeneration and non-violence, and by the constitutional ideals of the westernized middle class, Indian nationalism remained moderate in its objectives and methods.[8]

While Gandhi's appeal to tradition was highly selective and infused with a kind of liberal humanitarianism, it did produce some difficulties after independence. Many orthodox Gandhians

[8] This generalization holds true for the dominant strain of Congress thinking in the thirties. The Congress Socialists preferred more radical goals, but the Gandhian view prevailed.

continue to confuse poverty with simplicity, which is "good," and industrial productivity with materialism, which is "bad." This fruit of the Gandhian heritage is especially unfortunate because it re-enforces the weakness of colonialism in the sphere of economic development. But here again India has benefited from the pluralism of its national movement; Nehru does not suffer from these particular confusions.

Gandhi's self-conscious appeal to tradition rested on a reformed version of tradition. His active crusade for the untouchables and for inter-caste amity divided him from Brahminical orthodoxy, and his special concern for the individual in whatever station in life introduced a humanitarian and democratic strain into Hindu social thought. His reorientation of the traditional culture made possible what must be a rarity in the contemporary world, an effective reform movement drawing its inspiration and direction from the traditional culture. His traditionalism did not, therefore, involve a fundamentalist reaction.

The third difficulty to be anticipated from popular nationalism is divisiveness. Gandhi's best efforts notwithstanding, he did not succeed in keeping Hindus and Muslims together within the national movement. The fear that colonialism would be succeeded by Hindu rule spawned a new nationalism among Muslims which eventually led to partition. But other divisions within India, which were accentuated as politics became more popular, have had a more ambiguous meaning. For example, Gandhi used India's linguistic-cultural units as the basis of the Indian National Congress' organization. They provided for many a sense of belonging and purpose which the more abstract appeals of Indian nationalism could not provide. Like caste, which we shall discuss at some length below, the linguistic-cultural divisions of India help link the individual to the political process. Until voluntary associations—parties and interest groups of various kinds—have reached a fuller state of development, natural associations like the linguistic-cultural unit can provide the necessary sense of identity, structure and basis for leadership. Such natural associations are also a potential source of political instability, if they are not contained within the bounds of national loyalty. To date, however, these linguistic cultural units, though they have sporadically threatened the unity of India, have remained subordi-

nate to it. So long as they continue to provide the sense of identity and community necessary in any society, and so very much in short supply in underdeveloped areas where old bonds have crumbled before new ones have emerged, they can serve to prevent the disintegration and atomization of Indian society.

Thus the three problems which popular nationalism might have created for post-independence politics—demands running ahead of capacity to satisfy them, a reversion to traditionalism threatening the modern culture, and internal divisiveness—have proved to be assets in some respects. By his gradualist approach to reform, Gandhi on the one hand created a sense that nationalism had popular relevance, and on the other created a spirit of moderation. By his reformist approach to tradition, he was able to involve the Indian masses without losing the westernized elite. While the divisions emphasized by popular nationalism resulted in the loss of Pakistan, they provided the basis on which politics could be made relevant to all Indians by preserving a sense of identity and community within the nation.

One of the key problems in underdeveloped countries today is how to insure that public office will remain a place of trust and not of profit. When the seats of power and administration are filled by birth, and authority is largely traditional, the distinction between public and private realms is unknown. One of the reforms which the British Residents tried to introduce in the Princely States for example, was a distinction between the princes' personal income and state revenues. Today, with popular leadership and authority ascendent, such a distinction is assumed to exist, but practice lags far behind the norm. Thus while some of the arrests by the Ayub Khan regime in Pakistan were politically inspired, some were explicitly for corruption. In Iran, the Shah recently issued a series of decrees designed to create the appropriate distinction. The most important one, which may be the most difficult to effect, provides that no elected or appointed official may do business with the government.[4]

Politics in underdeveloped areas is often dominated by cliques led by a few outstanding personalities. Without a coherent political philosophy or systematic policy objectives, these cliques are

[4] For recent reports on these countries see Elie Abel, "What Went Wrong in Pakistan," *New York Times Magazine*, November 30, 1958 and Hal Lehrman, "Keystone of the Northern Tier," *Ibid.*, February 22, 1959.

distinguishable more by personality than by program. Sometimes at the highest level, more generally at the lower levels, public office is regarded as a means of advancing the fortunes of followers, family and friends. These lapses in public morality and responsibility are not, of course, unique to underdeveloped areas. But the problem is much more serious among them, for the means of dealing with it are less adequate. Corrupt government undermines public confidence and fails to provide the goals which can inspire effort and sacrifice. All of these effects undermine political stability.[5]

India is by no means free of these effects. While the central government has, with a few exceptions, upheld public probity successfully, the state governments, like many in the United States, have been more susceptible to corruption. But the nationalist movement has left a heritage which helps to counteract these effects. The Gandhian ideals of service and self-sacrifice, of personal simplicity and humility, are still very much a part of Indian political life. Our impatience with unfamiliar forms of moralizing should not lead us to underestimate these ideals. They appeal to an important strand of the traditional culture, and because Gandhi practiced them within the living memory of many, they serve as standard and goal for conduct today.

The nationalist heritage also provided a vision of a new India. We pointed out earlier that Indian nationalism, unlike some others, was self-critical. It also developed an eclectic, in some ways internally contradictory, political philosophy and systematic policy objectives based on it. It had a positive program for Indian reconstruction as well as a negative one for throwing out the imperialist power. As a result, India emerged from the nationalist movement with a deep and broad commitment to social reform and economic development. Both in the realm of personal conduct and public policy, standards and goals are available to judge and guide individual action and governmental performance. Unfortunately, the idealism and social reform commitment which were so crucial a driving force are getting a little

[5] What the character of the increasingly important professional military regimes will be remains to be seen. In Pakistan and Burma at least the experience to date suggests that honest and efficient administration has been the standard for conduct and policy.

tired and becoming ritualized.[6] But so far, they continue to have some effect. Gradually, they are being supplemented by institutional checks, such as opposition criticism in and out of Parliament, the reports of Parliamentary Committees, particularly the Public Accounts and Estimates Committees, the press, the courts, public inquiry commissions, and regular elections. These institutional checks grow out of the colonial heritage rather than the nationalist heritage. Together with the ideal and policy orientation inherited from nationalism, they provide some kind of bastion against the moral disintegration and failure of purpose in Indian political life.

The organizational traditions of the nationalist era have also been a force for stability. India is a multiparty state, and the example of several underdeveloped countries—Ceylon, Pakistan—suggests that in such countries multiparty governments may create serious problems for stability and effectiveness.[7] To date, India has not faced these problems because Congress has won majorities in the central and most state legislatures and thus avoided coalition government. Congress' advantage over its opponents derives partly from its status as the party of nationalism and partly from the strong organizational structure, reaching down to the village, which it built during the nationalist period. Well articulated party organizations reaching down into the population are rare in underdeveloped areas, but crucial if the electoral process is to be more than a formality.

Other national parties also benefited from the national movement. The socialists, the Communists, and to some extent the right wing Jan Sangh, developed political skills and support under the umbrella of the Congress national movement. The result has been that party government under a Congress majority has been accompanied by some measure of electoral and parliamentary opposition.[8]

[6] The recent Nagpur Annual Session at which the Congress committed itself to ceilings on land holdings and cooperative farming was an attempt to revivify the party's ideological tone and restore its sense of direction.

[7] This is not meant to suggest that coalition governments are always unstable. European experience provides evidence on both sides of this question. Certainly a strong sense of political community and agreement on the constitution are important, and it is these factors which are feeble in underdeveloped areas.

[8] In the second General Election held in 1957 Congress garnered 48 per cent of the votes for the central legislature (Lok Sabha), the three "national"

The Congress Party's strong national organization built during the pre-independence period also provided an important means for dealing with personality, policy, regional and caste differences in the State parties. The intervention of national party leaders with great prestige has often, though not always, saved the State Congress parties from the serious consequences of party division. Experience to date suggests that government by a minority party or by a coalition at the state level usually results in weak and unstable governments.[9] A state cabinet supported by a majority in the legislature is very much preferable; it not only fosters stable government but also simplifies electoral choice by clearly fixing responsibility.

Finally, the fact that the same party controls both the central government and most state governments allows federal-state consultation and co-ordination to proceed not only through regular constitutional and administrative channels, but also through party channels. The problem of co-ordination in as large and complex a federal system as India's is eased by these relationships and national unity given a firmer meaning. In the not too distant future a diversity of parties may be holding power in the states and a coalition may even be in power at the Center. However, the precedents and conventions of the present more homogeneous period may ease the problems of operating a federal system in the context of greater party diversity.

This organizational heritage has another significance. In the transition from traditional to modern society and politics, the shift from natural to voluntary associations is crucial. It was suggested earlier in connection with linguistic-cultural divisions, that initially, natural associations under certain circumstances can provide structure and a sense of belonging in the new political processes. The elaboration of voluntary associations takes time and during the period of transition natural and voluntaristic fea-

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parties (PSP, CPI, Jan Sangh) 27 per cent, and independents and minor parties 25 per cent. In the Lok Sabha, Congress held 73 per cent of the seats, the three other national parties 10 per cent, and the independents and minor parties 17 per cent.

[9] In PEPSU, Travancore–Cochin and Andhra coalition or minority governments led to Presidential rule and new elections. In Madras, C. Rajagopalachari and later Kamraj Nadar's strong leadership enabled a minority Congress Government to rule until 1957 when the General Elections returned Congress with a decisive majority.

tures will be intimately intertwined. It is essential that as the traditional natural groupings lose their meaning, new ones arise to take up their functions. The failure to develop new forms of association accounts in large measure for the failure of efforts to conduct politics on a democratic basis in many underdeveloped areas today. The growth of the Indian National Congress as a nationalist movement and a party represents an impressive demonstration that voluntary forms of association providing a new basis for structuring the political life of the community have taken root in India.

The Role of the Agricultural Classes in Political Stability

One of the crucial factors affecting political stability in underdeveloped areas is the structure and outlook of the classes related to the land. While all countries falling under the rubric of underdeveloped aim at some measure of industrialization, agricultural pursuits rather than commerce or industry remain the largest single source of wealth and power. (The oil-producing countries of the Middle East, such as Saudi Arabia and Kuwait are of course exceptions.) What kinds of classes are there? how is population distributed among them? how politically self-conscious are they? do they play a part in the political life of the country and if so, how and with what consequences?

The structure of land relationships in subsistence agricultural economies can be divided for purposes of political analysis into four broad categories: 1) landed magnates; 2) landowners and landed peasants; 3) tenants; 4) agricultural laborers. These categories do not refer to specific legal or productive statuses. In India, the landed magnates would include the feudal *jagirdars* of Princely India, holding a few to hundreds of villages and exercising legal, revenue, and police powers; *zamindars,* who trace their origin to the tax farmers of the Moghul era and who were confirmed in the control of their former tax areas by British fiat; and many holders of large tracts of *ryotwari* lands, a type of holding which the British instituted in an unsuccessful effort to eliminate intermediaries and establish a direct revenue relationship between the government and the tiller. The power position of this first class had feudal overtones—we use this adjective

merely to suggest that their status included power and authority not only over those economically directly dependent on them but also broad political and social influence.

Land owners and landed peasants, the second category, range from prosperous owners of rather extensive lands who may accept tenants or cultivate with laborers, to small occupancy tenants, that is, tenants who, while not able to alienate the land which they farm, can be neither removed by the landlord nor prevented from bequeathing land to heirs. The large bulk of this class lays hand to plow. This second group is distinguished from those below it by being "propertied," though many at the lower margins are debt-ridden. In contrast to the group above it, which cherishes an aristocratic style of life, this group is more concerned with functional requirements of agricultural production than with the status and authority associated with landownership. This generalization is less true at the groups's upper margins.

The tenant, under this classification, is one who has no claim in law or custom to land, but rents it for fixed periods. Finally, the situation of the agricultural laborer is self-evident: he works for others, for wages or payments in kind. Neither of the last two classes has a "stake" in the land.[10]

This sketch of the classes related to the land not only suggests the structural complexity of the agricultural classes, but it also lays the basis for consideration of how the population is distributed among them, and how these classes stand in relation to politics. An agricultural economy in which landowners and landed peasants predominate will have quite different consequences for the stability and direction of politics than one which is dominated by landed magnates.

While control of a country's politics by a class of landed magnates is compatible with stability in pre-democratic traditional regimes, it may become incompatible with stability under conditions of incipient or effective democratic authority. Instability

[10] With the exception of the *jagirdars* and *zamindars*, the other classes in practice *may* be overlapping: A small landowner may, often through the agency of members of the extended family, farm additional land as a tenant, and may also work for other cultivators for wages. An occupancy tenant often has a sufficiently large holding that he will let part of his land to tenants at will or employ agriculture labor, or both. In the main, these four divisions are meant to describe status rather than legal or productive relationships.

may follow if such a class resists demands for broader political participation. Whether or not it consents in some measure to such demands, men with effective access to political power, whether through constitutional or revolutionary means, are not apt to suffer great social extremes gladly. Rather, they are apt to use their power to diminish the extremes. Thus it is the demand for popular participation and for social and economic justice that may produce conditions of instability under regimes dominated by landed magnates. If the problem of the landed magnates can be resolved peaceably, a source of potential instability is removed.

In India today the dominant agricultural groups are the occupancy tenant and the small and medium-sized owner, those whom we have classed in the second category. They are dominant both numerically among agricultural classes, and economically, since land reform removed the magnates as intermediaries in the collection of land revenue. The hold on the land of the *jagirdar* and *zamindar* is largely a thing of the past. Those who were the tenants of the great landed magnates have benefited from legislation which gives them the rights of occupancy tenants, confirms such rights where they were unenforceable before, and often makes it possible for them to acquire ownership rights. The consequence is that a kind of middle level peasantry often drawn from upwardly mobile, self-conscious agricultural castes is the leading agricultural class today.[11]

How is it that the landed magnates who until independence dominated much of the countryside have been neutralized as a political force in India? And what has this result to do with political stability? The development of a nationalist movement able to penetrate not only the high caste, western-oriented urban middle classes but also the more traditional lower castes and even the untouchable agricultural population has much to do with this result. Gandhi brought the modern and urban-oriented leadership of the Congress within his charmed circle and taught them neither to ignore, nor scorn, nor fear the peasant. Instead he taught them how to lead the agricultural masses of India. All the

[11] See Susanne Hoeber Rudolph, "Some Aspects of Congress Land Reform Policy," Center for International Studies, Massachusetts Institute for Technology, 1957 (mimeographed).

major nationalist leaders "discovered" the villages.[12] While building a mass nationalism, they promised the peasantry a better future. By 1947 they were committed to legislation which would begin to "give land to the tiller" by abolishing intermediaries—landed magnates like jagirdars and zamindars. The prospect of general elections based on adult franchise in 1951-52 held them to their commitment. Since then, extensive programs of tenancy legislation, rent regulation, and some agricultural labor acts have reached down toward the bottom two classes.

The agricultural legislation which followed upon Independence had a very important effect on political stability. In a democratic system where numbers count, satisfying a numerically small class of landed magnates is considerably less rewarding politically than satisfying the much more numerous land-owners and landed peasants. The Congress Government succeeded at a very early stage of its career in winning to its side an agricultural class which is often ignored, scorned, or exploited in the political systems of underdeveloped countries. And this class of peasant farmers, by its background and environment, is more likely to be loyal to the system that benefited it than are the more fickle "advanced" classes caught up in a stream of accelerating change. At this reading, the land owners and landed peasants seem more likely to play a role akin to their post-revolutionary French than to their Russian or Chinese counter-part, providing a broad base of small proprietors who have a vested interest in the present system rather than a source for exploitation for rapid industrialization.

Today's Congress majorities are at least partly the product of Congress land reform legislation. India's countryside contributed heavily to the 45 to 50 per cent of the popular vote the Congress received in 1952 and 1957, votes that have enabled Congress to govern on the basis of a democratic mandate.

If the support of the landowner and landed peasant group has momentary advantages for stability of the constitutional democratic regimes, it raises certain long-range problems. Conflict in the Indian countryside today grows out of the clashing interests

[12] See J. Nehru, *An Autobiography* (London, 1955), Chapters 8 and 9, and Rajendra Prasad, *At the Feet of Mahatma Gandhi* (New York, 1955), for the most prominent examples.

and aspirations of the landowners and landed peasants on the one hand and the tenant and agricultural laborer on the other. Like nineteenth century liberals in England and on the Continent, the landowner and landed peasant are quite prepared to be radical when facing the great landlords, rallying the propertyless to their banner under slogans of social and economic justice. But once they have gained their victory and face about from the old order which included their betters and governors to those they had encouraged from below, they, like their nineteenth century liberal counterparts, become conservative, concerned about the rights of property. Today the tension is between the landowner and landed peasant's capitalistic impulses and the demands of a still numerous tenantry. The tenant will be joined increasingly by the agricultural laborer as he becomes more self-conscious and effective politically and as the pressure of population on land increases even further. If Congress wishes to keep these last two categories of rural voters in its camp, it will have to lay further emphasis on tenancy legislation, ceilings, cooperative farming and the regulation of the conditions of agricultural labor.

A solid alliance between urban workers, discontented urban petty-bourgeoisie, and the two lower rural categories, constructed under Communist auspices, would be the most serious threat Congress could face. The still unresolved struggle in National and State Congress Party circles about the advisability of ceilings on land holdings and cooperative farming reflects this emerging conflict between the interests of the second category–landholders and landed peasants–and the third and fourth–tenants and laborers.[13]

A sub-committee appointed by the All India Congress Committee in October, 1958, to consider further steps in land reform policy recommended in December that

no uncertainty should be allowed to remain in the field of ceilings on existing holdings and the State Governments should take steps forthwith to apply ceilings thereon . . . the application of ceilings

[13] *New Age* (weekly), November 2, 1958, organ of the Communist Party, contains an attack on Congress' wobbling on the issue of setting ceilings on agricultural holdings. The attack clearly indicates the CPI's perception of the advantages to be gained by splitting the propertied from the non-propertied rural population and thereby undermining Congress support in the countryside.

is a part of the social obligation and is conceived in the spirit of social justice to large masses of people who come under the category of agricultural landless labour.[14]

Resolutions supporting the imposition of ceilings on landholdings as well as cooperative farming were passed at the Nagpur Session of the Congress in January, 1959.[15] The debate on the resolution and subsequent sharp discussions in Congress circles clearly reveal that the second category rural interests which have been satisfied by past legislation intend to resist any encroachment on their position in favor of the next two categories. The Communists swiftly joined the debate, endorsing the Nagpur resolution on ceilings in an apparent attempt to widen the crevices in Congress.[16] Whether Congress can keep the landholders and landed peasants even while playing for the lower rural groups remains to be seen.[17]

While the divisions in Congress seem quite acrimonious at the moment, the party may very well once again have its cake and eat it too. The endorsement of the Nagpur resolutions on land reform by the Communists indicates that Congress has again succeeded in not being outflanked on the left—thus saving its ideological respectability among Indian intellectuals and its support among lower urban and rural classes. At the same time, the fact that the land reform legislation is a State subject means that State Governments may be able to accommodate the reforms to the sentiments of the landed peasants even while making concessions to tenants and agricultural laborers.

The support of the land owner and the landed peasant groups,

[14] *Overseas Hindustan Times*, December 4, 1958. Congress calculates that there are 17,300,000 agricultural laborers in India. See *Economic Review*, February 1, 1959, p. 26.

[15] The resolution on "Agrarian Organizational Pattern" committed Congress to the objective of cooperative farming. Just what cooperative farming means for the present and future remains rather vague. For as clear a statement as is available to date see V. T. Krishnamachari, "The Place of Cooperation in Community Development," *Economic Review*, (Nagpur Congress Special Number), January 9, 1959, pp. 2-7.

[16] See K. Rangaswami, "Land Policy of Congress; Communist Support Analysed" *The Hindu Weekly Review*, March 2, 1959. See also report of action by the Central Committee of the Communist Party on February 25, 1959, in *The Overseas Hindusthan Times*, March 5, 1959.

[17] The issue is further complicated by the fact that Congress is unclear what effect the proposed reforms would have on productivity, and by the fact that the imposition of ceilings will yield much less land than would be sufficient to satisfy the landhunger of the landless.

as well as the rural non-propertied classes, raises an additional problem for long-range stability. The agricultural classes can not be pressed very heavily to provide economic means for industrialization if their support is to be retained. On the contrary, they are pressing for additional services, especially schools, clinics and roads in rural areas. To steer a course between satisfying legitimate rural needs and spending money on purely political concessions will take shrewd statesmanship.

The landowners and landed peasants tend to support Congress not only for its agricultural policy. They have another very good reason. Since Independence, they have increasingly been able to elect their own representatives to occupy positions of influence and power in government. While the central cabinet continues to be heavily colored by western-educated, urbanized, upper-middle class leaders, the spokesmen of rural interests increasingly sit in the State Ministries and on the benches of the Central and State Legislative Assemblies. The Chief Ministers of Madras and Rajasthan, for example, never received a liberal western style education but have a shrewd touch with the rural classes of their states. They are only two of many such state ministers. The satisfaction derived by the more self-conscious of the rural population from having their "own" representatives, men risen from similar backgrounds, in office should not be underestimated. The fact that a large segment of the peasantry are not "forgotten men," not a vast inarticulate and submerged presence, plays a vital part in buttressing political stability in India.

Political Organization and Leadership in the Mass Electorate; the Role of Caste

The reasonably successful attachment of a large section of the peasantry to the political life of India is not to be explained solely by the Gandhian-inspired awakening of the rural population. Ironically, India's ancient caste system plays a vital role in linking the peasant to modern democratic politics.

The plaint heard today from many scholars of underdeveloped countries, that the failures of western-style democratic processes are in large measure due to the lack of local associations capable of structuring the rural masses and linking them to the political

life of the nation, is not one which can be raised in the Indian case. Of the countries of the Middle East, Sir Hamilton Gibb has written:

In a democratic system political leaders are expected to respond to popular will as expressed in institutions from parish councils and town meetings right up to the most comprehensive organizations. But it is precisely the great weakness of Arab countries that, since the breakdown of the old corporations, no social institutions have been evolved through which the public will can be canalized, interpreted, defined and mobilized. Elective institutions at the lower levels practically do not exist. No functional associations link representatives from different areas. There is, in short, no functioning organ of social democracy at all.[18]

Lucian Pye, basing his remarks on the Malayan case, observes that "there is a profound inarticulateness in societies which are engrossed in extensive cultural change. There are few means of identifying the deeply held convictions latent in public opinion."[19] Pye argues that one of the essential requirements in combating Communism in Malaya is a sense of community at the local level and means of association and organization to link such communities to the political process.

If Gandhi touched the masses and enabled them to see, however dimly, the larger world of public affairs and political activity, caste provided a basis for the organization and leadership of politics. Traditionally, caste is an inward-looking form of social organization devoted to the regulation of marriage, commensality, ritual and the religious life, law and order within the group, and the relationships of the group to other groups. Until recently, the most important aspect of the caste structure was the maze of sub-caste groupings which concerned themselves with these internal regulations.

Beginning at about the turn of the century, caste began to look outward. It began to become as concerned with its relative status in society as with the internal enforcement of caste norms. With the increasing economic opportunities offered by trans-

[18] Sir Hamilton A. R. Gibb, "Social Reform: Factor X; the Search for an Islamic Democracy," in Walter S. Laquer, ed., *The Middle East in Transition* (New York, 1958), p. 8.

[19] Lucian Pye, *Guerilla Communism in Malaya: Its Social and Political Meaning* (Princeton, 1956), pp. 346-47.

portation and technological change, "social climbing" by entire castes became increasingly common.[20] Political activity serves this outward-looking interest because political power can aid the drive of the caste for higher status. With the coming of democratic politics and the replacement of quality by quantity as the basis of authority, caste has taken a new lease on life. Today, its socio-religious functions are declining as its new-found political functions develop. Modern means of transportation and communication have the effect of broadening the scope of caste, binding together many local sub-groups of single castes into geographically extended associations.[21] These new extended organizations became clearly visible in the 1920's and were given new impetus after Independence. They are capable of serving as vehicles for political organization in individual constituencies and even states. Caste *sanghams* (organizations) became the order of the day providing ready-made political organizations for the political leadership of upwardly mobile castes.

Its new found political role has had a profound effect on this traditional association. The logic of numbers, the need to mobilize majorities in MLA (Member, Legislative Assembly) and MP constituencies and even states, has driven the caste to define itself for political purposes ever more broadly. As the political functions of caste expand membership in the *sangham*, the political organization of caste, increasingly becomes a matter of *choice* rather than *birth* for ever-wider groups. As the hold of sub-caste councils of elders gives way to younger political leaders drawing their strength from *sanghams*, the functionally diffuse authority and leadership of the sub-caste gives way to the more specialized political roles and functions which the caste can support in the political realm. Finally, a movement away from a multiplicity of sub-cultures and norms, which caste in its traditional form repre-

[20] See Census discussions for Madras in 1891, 1901, 1911, 1921, and 1931 for illustrations of this point.

[21] For confirmation of this point as well as the new political role of caste see M. N. Srinivas, "Caste in Modern India," *The Journal of Asian Studies*, XVI, 4, August, 1957; Selig Harrison, "Caste and the Andhra Communists," *American Political Science Review*, L, June, 1956; M. L. P. Patterson, "Caste and Politics in Maharashtra," *Economic Weekly*, VI, 39, September 25, 1954; and "Profile of a Southern State—Mysore," *Economic Weekly*, VIII, 29, July 21, 1956. See also G. S. Ghurye, *Caste and Class in India* (Bombay, 1957), Chapters 8 and 9 for impact of "caste patriotism" on public life and politics.

sents, towards fewer and broader cultural units and norms, can be discerned in the merging of sub-castes for political purposes into the broader *sanghams*.

Caste in its political role is most clearly identified in the *sangham*, a voluntary association which those who qualify by birth may join but into which the individual is not automatically placed by birth. Analytically, the *sangham* lives in a twilight zone between voluntary and ascriptive organization. The *sangham* is politically most visible in nominations for elective office, and as an interest group lobbying for rights and privileges from the Government. The 1957 election further accentuated the trend already visible in the 1952 election: The caste with the largest plurality (usually not exceeding 20% but more often closer to 10%) in an election district dominated the nomination selections of all parties. Castes wielded this influence both via *sanghams* and even without such explicit organization.

In Rajasthan we found that during both the 1952 and 1957 campaigns the *Kshatriya Mahasabha* (the *sangham* of the Rajput caste) was converted from a purely social organization into a frankly political one. The *Mahasabha* along with the *Bhooswami Sangh* (organization of small Rajput landowners who broke off from the parent body between the two elections over the amount and method of compensation provided by the land reform legislation in Rajasthan) participated directly in politics, nominating candidates and organizing and co-ordinating electoral activity. More impressive is the far-flung *sangham* of the *Vannya Kula Kshatryias* of Madras, an organization of small peasants of related sub-castes. It became sufficiently powerful in the Madras political scene to form a party and to be accommodated in the state cabinet. In general, the pattern of state tickets and cabinets balanced by caste pervades Indian politics today.

Caste plays a political role not only in its manifestation as *sanghams* but also in the form of the sub-castes which together comprise the structure of even the smallest village. With a very high rural illiteracy rate and with the mass media playing only a marginal role in the electoral process, campaigning among the rural population in fact means village by village appearances. The candidate tries to address as large a village gathering as he and his aides can muster. But equally if not more important are his

conversations with the headmen of village castes. The unit which makes the electoral decisions is much more likely to be the subcaste or the extended family (which are, of course, intimately related) rather than the individual.[22] Thus, gaining a commitment from a caste headman may be much more important than any number of public speeches. The parallels with urban ethnic politics in America are striking.

Among castes in which the *sangham* type of self-consciousness has grown quite strong, so that the unit of electoral choice transcends the face-to-face group of the village subcaste organization and extends instead to a relatively broad geographical area, *sangham* leaders play an even more decisive role. While traveling from village to village in the party of a Congress candidate in Madras during the 1957 campaign, we were introduced, for example, to a man who, we were told, "controlled" 10,000 votes. Even allowing for considerable exaggeration, this is still an impressive figure. In another instance, we watched a highly successful member of a formerly backward but now upwardly mobile caste address a village meeting of roughly 400 people. After he had finished, a Congress labor organizer from Madras city, a western educated Brahmin, began to speak about the Second Five-Year Plan. Rising from his seat on a front bench, an elderly but vigorous man sporting a walrus moustache stood up and cut him off. Our interpreter explained that he was the head man of the dominant caste in the village, the same caste as that of the featured speaker, and that he had said that the village had no need for further speeches. Their kinsman had advised them what to do and that was sufficient. In this case, rural caste solidarity and a network of trust based upon it was still considered much more significant than the influence of an urban leader who represented the authority of modern culture. The story makes an interesting contrast to those interpretations of the political process in under-developed areas which see a fragmented and passive peasantry acquiescing in the leadership of a superior urban elite.

We have gone into considerable detail concerning the role of the caste in politics in order to make quite clear that it does make

[22] See Lloyd and Susanne Rudolph, "Surveys in India; Field Experience in Madras State," *Public Opinion Quarterly* XXII, Fall 1958, pp. 237-38.

possible the organization of the rural masses for political purposes.

The fact that caste is a basis of political organization, that caste leaders are often able to speak for their followers and to affect their voting behavior, is usually interpreted as evidence that democracy is failing in India. This interpretation assumes that democracy cannot operate until individuals make independent, informed electoral decisions on rational grounds, an assumption that is sceptically viewed by many students of western democratic politics. Western electoral processes have always relied on substantial elements of non-rational and even irrational perceptions and motives. In the west, for example, ethnic, religious, and economic associations have operated in politics along lines which are functionally comparable to that of caste in India today, blending rational, non-rational, and irrational perceptions and motives in the organization and direction of the political behavior of their members. The matter of degree obviously differs in comparing east and west. And the fact that western associations tend toward the voluntary rather than the ascriptive type also must be noted. But instead of dismissing out of hand the role of caste in fostering democratic politics in India it may be well to ask whether under Indian circumstances the caste grouping and its leaders do not serve an important function in attaching broad sections of the population to the unfamiliar mechanism of modern democratic politics.

In other under-developed countries, as Gibb and Pye among others have pointed out, it is precisely the eclipse of traditional associations without the emergence of new ones to replace them which has led to disillusionment concerning the possibilities of democratic government. Through a familiar, traditional channel, caste organization and its leadership provide the means whereby the bulk of the population, which in other areas remains mutely outside the political system, is able to be integrated into democratic political processes.

Caste is also the basis of division and friction in Indian society. It often inspires parochial attitudes towards issues of public policy and serves in many insidious ways to undermine universalistic achievement norms in all walks of life. Caste is obviously a very mixed blessing. It is therefore to be hoped that even while

it now serves as a familiar old container for the new democratic product, the future will see its replacement by more purely voluntary organizations based on individual commitment. But is there a functional equivalent for caste in the social structures of other under-developed countries? If so, have the leaders or can the leaders of these societies penetrate to the masses, as Gandhi did, to give them a glimpse of a broader world than that which their immediate environment provides? With or without leadership capable of touching the rural masses, ever larger sections of the populations of under-developed countries will in any case be affected by the mass media[23] and, at a slower pace, by education. Assuming that an under-developed country does not fall into the hands of a totalitarian party, is there anything in the traditional structure of its society which is capable of transformation into a usable and effective instrument for the conduct of popular politics? The stability with which the modernized elites now occupying the seats of power in most under-developed nations are able to govern is intimately related to this question. The gap which Lucien Pye discusses in his *Guerilla Communism in Malaya* is, along with the outlook, quality, and social bases of this leadership, a result of the difficulty of organizing the bulk of the population for purposes of popular political participation.

The emergence of caste's political role in democratic politics has had several consequences. First, it provides the channel through which rural populations, whose support for Congress has already been discussed, make their views heard in party councils and try to foster favorable governmental policies and action. It is also the channel through which the Congress and other political parties are able to mobilize the support of the rural and, to a lesser extent, the urban population. This channel is essential if the party system and Congress in particular is to maintain its strong position in the countryside. A second more general consequence is that caste makes the new institutions of constitutional democracy meaningful in traditional terms, moderating the gap between its values and assumptions and the perceptions and attitudes of the mass of people. These consequences must be weighed

[23] See Daniel Lerner, *The Passing of Traditional Society: Modernizing the Middle East* (Glencoe, 1958).

against the opposition which caste offers to the acceptance of democratic values and achievement norms.

A Look at the Future

What are the consequences of having the rural masses play an active and effective part in politics? The fact that India stands almost alone among the under-developed countries of the world in maintaining political stability under a system of constitutional democracy is at least in part due to the steady and broad support which large segments of the rural population have given it. This has meant that her planning and development activities have been able to move ahead with vigor, continuity, and popular support.

But she has also paid a price. The peasant in democratic politics cannot be sacrificed as he has been in Russia and China in the interest of rapid development of heavy industries. He is a voter and a taxpayer. Today, the burden on the tax paying landowner and landed peasant in India is, on the whole, lighter than it was under the British when the landed magnates in many areas acted as intermediaries between government and tiller. Even those who are tenants today have benefited greatly from tenancy legislation, which has given them more and the landowner less of the produce pie. In Madras, for example, the Congress won a smashing victory in the 1957 General Elections by outbidding the Communists in giving the tenant farmer 60 per cent and the owner 40 per cent of the value of the crop. Rents, then, are down, and revenue rates are no higher and in some places lower than they were under the British. Financial resources for industrial development remain a pressing need with little prospect under present conditions of getting much more from the agricultural sector of the economy.

If the agricultural sector of the population continues to gain in strength politically and its leaders increasingly occupy the seats of power and decision, what will be the effect on the direction and speed of development? Will the drive for industrialization maintain its present momentum? The outlook of the landowner and landed peasant, even the very small one, is more conservative, more traditional, than that of the modernized urban elite. In alliance with the old commercial middle classes, he may substantially change the pattern of India's development. Much

depends, of course, on the balance of forces between the urban white collar and industrial workers and the rural non-propertied classes, on the one hand, and these more conservative elements on the other.

The revolution in expectations and the greater efficiency and effectiveness with which urban and industrial classes participate in politics will force *any* government sensitive to the requirements of winning elections to maintain much of the present momentum, perhaps even to increase it. Still, in so far as the landowner and landed peasant maintain an effective voice in Government, they can be expected to lend a different complexion to policy and the efforts to mobilize resources for furthering change than would a dominant modernized urban elite. Thus, this present force for stability may, by introducing conservative rigidities into India's economic and social programs, become a force for instability by sufficiently slowing the pace of development to prevent it from keeping up with the pace of expectations.

Conclusion

The strengths which India's democratic constitution has revealed to date derive partly from the colonial and the nationalist phases, and partly from certain post-independence phenomena. A number of forces which are sometimes ignored have been selected for discussion in these pages. During the long colonial period, India developed a large class of nationals experienced in and committed to the norms and methods of rational administration and legal and parliamentary activities. This class is probably larger, and more deeply committed, than comparable classes in other former colonial areas. Gandhian mass nationalism was influential in connecting the westernized elite produced by the colonial impact with rural India, preparing that elite both psychologically and organizationally for an era in which its legitimacy would rest on popular sovereignty. Because of the experience of the nationalist phase, Indian politicians have been less alienated from those whom they seek to lead than politicians in many other under-developed areas.

The nationalist period also provided the organizational structure which has enabled Congress to maintain its stable majority. In the post-independence phase, the Congress Party rallied to its

side a large section of the agricultural population through a legislative program aimed at removing the great landed magnates. The result of agricultural reform to date has been to buttress and enlarge a substantial class of landowners and landed peasants. This class not only is committed to the system but also, at the state level in particular, holds office and has the decisive voice in policy formulation and execution.

The transformation of caste from an association devoted mainly to social regulation into an institution through which new democratic-electoral processes are made meaningful to the electorate helps to link the mass electorate to the political process. It "bridges" the gap between the assumptions of democratic institutions and leadership and the traditional society.

While the last two developments are contributions to political stability in a setting of constitutional democracy, they also are a source of potential difficulties, the first by the possible threat it poses to the pace of economic development, the second by its potential contradiction of democratic values and individual achievement norms.

The four factors discussed in these pages represent areas of strength in contemporary Indian political life. They may be more durable than the life of India's Prime Minister which is so often considered crucial to India's continued stability. While it would be dangerous to ignore the importance of the quasi-magical unifying influence Nehru exercises, obsession with his survival has often obscured other elements in the Indian political scene. The forces explored in these pages may warrant a cautious optimism concerning India's political future.

FOREIGN EXCHANGE SHORTAGE AND INFLATION UNDER INDIA'S SECOND PLAN

*Michael Brower**

AFTER the apparently smashing success of the First Plan, India's Second Plan ran almost immediately into very serious difficulties, from which it has by no means yet emerged. The First Plan acccomplished a better than expected 18 per cent growth in national income in five years with investment levels below those planned, and during this period foreign exchange reserves were drawn down less than one-half as much as had been planned. Although inflationary tendencies were evident towards the end of the plan period, they had not become a cause for alarm, and prices were still considerably below the 1951-52[1] high level. The Second Plan had barely begun, however, when foreign exchange reserves began a precipitous drop which has continued virtually unabated to the present. Inflation, especially in food prices, became recognized as a problem meriting serious Government attention, and in some sectors greater than expected investment levels proved necessary to meet Plan output goals. In response, the Government tightened import controls, curtailed foreign exchange transactions, attempted to stimulate small savings flowing into Government coffers, imposed new taxes, began a major food importation and distribution program, set up export promotion programs, went shopping abroad for increased foreign assistance, and decided to cut back the plan to a "hard core."

This paper examines two of these problems: declining foreign exchange reserves and inflation, and some of their causes. It is based, for the most part, on material available in Cambridge through April of 1958.

Although this paper may appear in places to be somewhat critical of the Plan or of its execution, it should not be thought

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[1] Indian plan and fiscal years run from April 1 to March 31.

that there is any intention to be derogatory about the plan as a whole or about India's progress towards her goals. No one who has studied in any detail the difficulties of India's economic position, the heroic nature of her goals, the thoroughness of her two plans, and the devotion of her leaders and people to democratic methods, can help but be strongly impressed by the way she has resolutely tackled her problems and by the positive results to date.

Indeed, the two problems examined here are, in part at least, symptoms that economic development is taking place at a faster pace than previously. If such difficulties as these had not arisen it might well have been a sign that India's goals were not sufficiently ambitious. At any rate, it is perhaps inherent in democratic economic planning that not all factors be so tightly controlled as to preclude the occurrence of unexpected and undesired tendencies. But from the study of the experiences of one pace-setting country, perhaps later efforts of that country and of the others following in its course can be saved from running into at least some of the same shoals.

The Foreign Exchange Shortage

During the five years of the First Plan the total reserves decline was only Rs. 121.3 crores,[2] or less than one-half the anticipated Rs. 290 crores. Over this period a negative trade balance of Rs. 506.5 crores was largely offset by positive surpluses of Rs. 383.4 crores in invisible earnings and Rs. 97.1 crores of official donations. The current balance deficit of Rs. 26.0 crores plus Rs. 78.5 crores of "errors and omissions" was almost equaled by income from official loans totaling Rs. 99.4 crores over the five-year period. However, an outflow of Rs. 116.2 crores on capital account brought the actual foreign exchange gap, filled by drawing down reserves, to Rs. 121.3 crores.

In each of the last four years of the First Plan period there was a current account positive balance. And with capital transactions included, there was a net addition to reserves in three of the four years, including the last one, 1955-56. The whole deficit can thus

[2] The rupee (plural abbreviated Rs.) is the Indian monetary unit. One rupee equals about $0.21. The crore is an arithmetic unit equal to 10 million. To roughly translate Rs. crores into $ millions, one can multiply by 2 and add 10 per cent of the original number.

TABLE I

India's Balance of Payments During the First Five-Year Plan

(Rs. Crores)

	Pre-Plan 1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	Total for Plan
Imports	650.3	962.9	633.0	591.8	681.6	747.7	3,617.0
Exports	646.8	730.1	601.9	539.7	596.6	642.2	3,110.5
Trade Balance	— 3.5	—232.8	— 31.1	— 52.1	— 85.0	—105.5	— 506.5
Invisibles	40.3	64.9	80.5	80.5	77.5	80.0	+ 383.4
Official Donations	2.1	5.3	10.8	19.0	15.8	46.2	+ 97.1
Current Account Balance	38.9	—162.6	60.2	47.4	8.3	20.7	— 26.0
Errors and Omissions	— 6.7	— 45.0	— 25.7	+ 2.3	— 12.9	+ 2.8	— 78.5
Official Loans	+ 7.7	+ 59.6	+ 35.1	+ 1.6	+ 0.6	+ 2.5	+ 99.4
Other Capital Transactions	— 12.7	— 20.6	— 51.1	— 20.3	— 13.2	— 11.0	— 116.2
Change in Reserves	+ 27.2	—168.6	+ 18.5	+ 31.0	— 17.2	+ 15.0	— 121.3

Source: *Report on Currency and Finance, 1955-56.* (Bombay: Reserve Bank of India, 1956), p. 70.

Note: Many of the 1954-55 and 1955-56 figures have since been revised, but all changes are not yet known (1954-55 "final" capital account figures are not accessible in this form, and 1955-56 figures are still "provisional"). In every case the changes are insignificant for present purposes.

be accounted to 1951-52 when imports rose suddenly for one year only. From then until the end of the First Plan, India's was a "model" balance of payments, if one accepts the assumption that an underdeveloped and developing country could and should hold balance of payments deficits to a very small amount.

Almost from the very beginning of the Second Plan the foreign exchange picture began to darken ominously, and month after month the assets continued to drop. Table II shows that from the end of March 1956 to the end of March 1957 gross foreign exchange assets declined by Rs. 141.18 crores, and liabilities rose by Rs. 37.02 crores, so that net assets showed a drop of Rs. 178.20 crores. There was an actual further use of net assets during the year of Rs. 67.74 crores which was hidden and wiped out when India's previously undervalued gold coin and bullion was revalued in October 1956 from Rs. 21.24 per tola (3/8 of an ounce) to Rs. 62.50 per tola. In a way, this "paper gain" could be called a one-time-only foreign exchange earning, but to show the true amount of reserves usage the gross and net asset figures must be corrected by this amount. When this is done we see that a total of Rs. 245.94 crores was used in 12 months. Net assets declined, moreover, another Rs. 191.07 crores in the next 6 months, for a total drain in 18 months of Rs. 437.01 crores. These figures are to be compared with a Second Plan budgeted decline for the whole five years of only Rs. 200 crores. Thus, in the first year of the plan more reserves were used than was allocated for the whole five years, and in the first year and one-half more than twice the allocation was used.

A number of authors have argued that India actually utilized even more foreign exchange during these 18 months than these figures show, because she drew Rs. 61 crores worth of dollars from the IMF during the first quarter of 1957 and Rs. 34.5 crores worth in June of 1957. However, because these loans were entered in both the gross assets and liabilities columns of Table II, the net assets figure is unaffected by them. Had India not received the Rs. 61 crores loan in 1956-57, her gross assets would have shown a fall greater by Rs. 61 crores than the present figures indicate. But at the same time her liabilities, instead of increasing by Rs. 37.02 crores during the year, would have declined by Rs. 23.98 crores. (Evidently India was using some of her assets

to retire liabilities of this amount during the year.) And the net asset position would have shown the same decline: Rs. 178.20 crores for the year on paper, and a real decline of Rs. 245.94 crores when the revaluation gain is subtracted.[3]

TABLE II
India's Foreign Exchange Reserves
(Rs. Crores)

	Gross Assets	Liabilities	Net Assets
End of:			
March 1956	842.60	80.86	761.74
March 1957	701.42	117.88	583.54
Twelve month change	—141.18	+ 37.02	—178.20
Less "Paper Gain"	— 67.74	——	— 67.74
Real Change	—208.92	+ 37.02	—245.94
March 1957	701.42	117.88	583.54
Sept. 1957	531.11	138.64	392.47
Six-month change	—170.31	+ 20.76	—191.07
Total eighteen months change	—379.23	+ 57.78	—437.01

Sources: *Reserve Bank of India Bulletins.*

The immediate cause of the sudden and drastic decline in reserves is seen in the current account of the balance of payments (Table III). From a positive balance of Rs. 13.4 crores in 1955-56, the current account showed a deficit of Rs. 297.1 crores in 1956-57 and of Rs. 207.4 crores for the first half of 1957-58 alone. These imbalances were almost totally due to rising im-

[3] Sterling balances are frequently cited to show how much foreign exchange has been used. Despite the fact that, except for the base holdings of gold, most of India's foreign exchange assets are held in Sterling, this is not the most accurate method of measuring drafts on foreign exchange. During 1956-57, for example, Sterling fell by Rs. 219 crores. Since gross assets fell by about Rs. 10 crores less during this period, it is evident that this amount of Sterling was transferred into other foreign asset holdings in the course of the year. Thus changes in Sterling do not coincide with changes in gross assets. Nor do changes in Sterling balances take account of liabilities changes. Furthermore, the drop in Sterling balances (unlike that in net assets) is less than it would be by the amount of any IMF loans utilized, so these amounts must be added to the drop in Sterling balances to get a somewhat truer picture of total asset usage. On the other hand, the use of Sterling balances as a measure does have the advantage for this particular year that they are not affected by the gold revaluation, for which there is therefore no correction needed.

ports, which shot up from Rs. 750.6 crores in 1955-56 to Rs. 1076.5 crores in 1956-57 and to Rs. 622.2 crores in the first half of 1957-58. It is also worthy of note that the receipts from official donations have been falling somewhat from their 1955-56 high point.

TABLE III

India's Balance of Payments–Current Account

(Rs. Crores)

	1955-56	1956-57	1st half 1956-57	2nd half 1956-57	1st half 1957-58
Imports	750.6	1,076.5	476.8	599.7	622.2
Exports	641.1	637.0	288.3	348.7	341.5
Trade Balance	—109.5	— 439.5	—188.5	—251.0	—280.7
Invisibles	+ 84.4	+ 107.2	+ 44.7	+ 62.5	+ 50.8
Official Donations	+ 42.0	+ 39.8	+ 17.9	+ 21.9	+ 6.5
Errors & Omissions	— 3.5	— 4.6	+ 10.6	— 15.2	— 16.0
Current Account (Net)	+ 13.4	— 297.1	—115.3	—181.8	—207.4

Source: *Reserve Bank of India Bulletin*, March 1958, pp. 344-5. (Or other recent *Bulletins*.) For "1st half, 1956-57," earlier *Bulletins*.

Note: The 1955-56 figures here do not agree with those in Table I. As the figures given here are later figures, they are followed in the analysis below.

Exports, in one sense, were hardly to blame at all for the 1956-57 deficit, as they declined only slightly (Rs. 4 crores) from 1955-56 to 1956-57. But in another sense the trouble might be partially laid to export failings, for one could perhaps expect them to rise with imports (as they did in 1955-56 over 1954-55) to help pay for the cost of development.[4] At first glance it appears that 1957-58 exports, at Rs. 341.5 crores for the first half, were increasing, not over the previous half year—which is the wrong comparison to make as India's exports are largely seasonal in pattern—but over the first half of 1956-57. This, however, is not the case; 1957-58 exports were actually declining even farther. From the Rs. 341.5 crores for the half year shown in Table II must be subtracted Rs. 74.4 crores of government silver exported to the United States in payment of wartime Lend Lease. This leaves only Rs. 261.1 crores of regular exports for the half year, which is a very sizable drop from the previous levels.

[4] The planners, however, anticipated only a slow and slight rise in export earnings. See *Second Five-Year Plan*, pp. 96-7.

It is often observed that the rising level of imports is the "fault" of the private sector of the Indian economy, and the implication is that Government, or public sector, imports have been a negligible, or at any rate "well-behaved" influence in the picture of declining foreign exchange reserves. From Table IV we see that this is by no means the only possible interpretation. Private sector imports reached a peak proportion of 82.9 per cent of total imports in the first quarter of 1955-56 (long before the crisis began) and, except for two quarters, have been declining as a share of total imports ever since. In other words, while both sectors have been increasing their imports, the public sector has been doing so at a faster rate. (Obviously no value judgment should be imputed to these observations, isolated as they are from over-all considerations of India's desires, needs and plans.)

The flood of imports in 1956-57 was by no means a reversal of recent experience; it was rather the acceleration of a trend. The two previous years showed import increases of 15.5 per cent and 9.8 per cent. In the last quarter of the First Plan imports rose 12.8 per cent (equivalent to well over 50 per cent annual increase if continued for a year). This was the second highest rate of increase of any of the quarters under review here. Thus the balance of payments crisis was not of the Second Plan alone, but was actually building up a head of steam late in the First Plan. The crucial importance of adequate up-to-date statistics to the controlling of a planned or partially planned economy is aptly illustrated here, for had the quarterly trend in imports been watched closely by administrators with the power and the will to take action, appropriate steps could have been taken much earlier than they were to stem the rising tide.

Average value and volume indices for Indian imports[5] do not support the contention of some authors that a large proportion of the increase in total cost of imports was due to price rises rather than to volume increases. Although yearly indices for 1956-57 are as yet not available, an analysis of the trends in monthly indices for this period by the author suggests that prices of imported goods may have been 3-5 per cent higher in 1956-57 than in 1955-56. This would mean that at the outside Rs. 54 crores

[5] See, for example, *Reserve Bank of India Bulletin*, March 1958 for 1957 figures, and December 1957 for earlier figures.

TABLE IV

Private and Government Sector Imports of India

(Rs. Crores)

Period	Total Imports	Per Cent Change	Private Sector	% Change	% of Total	Public Sector	% Change
1952-53	633.0						
1953-54	591.8	— 6.5					
1954-55	683.8	+15.5	523.9		76.7	159.9	
1955-56	750.6	+ 9.8	611.7	+16.7	81.8	138.9	— 13.1
1956-57	1,076.5	+43.4	795.9	+30.2	73.4	280.6	+102.0
Apr.-June 55	176.7		146.6		82.9	30.1	
July-Sept. 55	177.0	+ 0.2	144.3	— 1.6	81.6	32.7	+ 8.6
Oct.-Dec. 55	185.8	+ 5.0	148.6	+ 3.0	80.0	37.2	+ 13.7
Jan.-Mar. 56	209.5	+12.8	170.5	+14.7	81.5	39.0	+ 4.8
Apr.-June 56	230.3	+ 9.9	196.1	+15.0	85.1	34.1	— 12.6
July-Sept. 56	246.6	+ 7.1	195.5	— 0.3	79.3	51.1	+ 49.8
Oct.-Dec. 56	294.0	+19.2	209.6	+ 7.2	71.3	84.4	+ 65.1
Jan.-Mar. 57	305.7	+ 4.0	194.7	— 7.1	63.7	111.0	+ 31.6
Apr.-June 57	323.1	+ 5.7	201.0	+ 3.2	62.3	122.1	+ 10.0
July-Sept. 57	299.1	— 7.4	182.5	— 9.2	60.9	116.6	— 4.5

Sources: *Reserve Bank of India Bulletins.*

Note: Quarterly figures for 1955-56 total less than Rs. 750.6 crores as they are from earlier estimates.

of the Rs. 316 crores increase in total cost of imports from 1955-56 to 1956-57 was due to price increases. This is a sizable amount (about 17 per cent of the total import jump), but by no means the predominant factor.

The use of these indices in this manner is open to a number of valid objections. One is that the monthly indices are so erratic that it is questionable whether they offer more than a rough clue to the yearly index. Another is that these indices are based on 1952-53 weights, and that the composition of Indian imports has been drastically changed since that date. To take this second objection into account a separate analysis was made of the trends in the indices of specific categories of Indian imports, such as iron and steel, machinery, and vehicles. The conclusion reached was, however, the same as that stated above.

When total imports are broken down into categories (see Table V), we see that the major increases from 1955-56 to 1956-57 came under three main headings in Indian statistics: capital goods, foodgrains, and "others."

(1) Capital goods imports climbed 48 per cent to Rs. 442 crores. The private sector imported 57 per cent more than in the previous year; the public sector, 40 per cent more.

(2) Foodgrains, all on Government account, were 3½ times, or 250 per cent above, the 1955-56 level.

(3) The "others" category (row IIId in Table V), which includes raw materials, consumer goods, and defense items, was up Rs. 92 crores (53 per cent). Of the total of Rs. 266 crores in 1956-57, almost 88 crores must have been on Government account;[6] perhaps much of this went for defense items.[7] The previous year this category included a maximum of Rs. 45 crores on Government account.[8] Thus nearly one-half of the increase in "others" could have been for defense items.

[6] Total public sector imports (Rs. 281 crores—see Table IV) less public sector capital goods (Rs. 91.1 crores) less foodgrains (Rs. 102 crores) leaves Rs. 88 crores. Some, but very little, of this may be among the five kinds of raw materials covered under "raw materials."

[7] Finance Minister Krishnamachari is reported to have said that Rs. 50 crores of the "others" category was for defense. See Jagdish Bhagwati, *The Present Imbalance in Indian International Accounts* (M.I.T. Center for International Studies dittoed paper dated November 1957), p. 14.

[8] Total public imports (Rs. 139 crores) less public sector capital goods imports (Rs. 65.2 crores) less foodgrains (Rs. 29 crores) leaves Rs. 45 crores.

On the other hand, the five kinds of raw materials imports listed separately in Indian statistics remained relatively steady as a group (although not individually). And, although the imports of two kinds of consumer goods rose considerably in percentage (22 per cent), this is numerically such a small item that it is perhaps more significant as an indicator of how imports of other, unspecified, consumer items may have increased.

To summarize: Of the total import increase of Rs. 326 crores between the two years, Rs. 143 crores (44 per cent) was in capital goods, Rs. 73 crores (22 per cent) was in foodgrains, and Rs. 110 crores (34 per cent) was in defense, raw materials, and consumer goods.

A proper analysis of the Indian foreign exchange crisis must not stop at asking "how much" and "why" imports rose above the previous levels. Because imports were expected to rise considerably during the course of the Second Five-Year Plan, it is necessary to ask "how much" and "why" imports rose above the levels anticipated in the plan. Compared to the actual imports of Rs. 1076.5 crores and the deficit of Rs. 336.9 crores on current account (exclusive of official donations), the plan allowed for 1956-57 imports of Rs. 783 crores and a deficit on current account of Rs. 148 crores (exclusive of official donations).[9]

But the plan was disappointingly vague about how this Rs. 783 crores of imports in 1956-57 was to be allocated. Breakdowns into specific kinds of imports were given in the plan only for 1960-61 and for the five years taken together (and from this an annual average was computed).[10] The estimates of plan intentions in column 5 of Table V are based on the detective work of Jagdish Bhagwati,[11] who drew his conclusions solely from statements found in the plan.

Bhagwati phased the total allocation in the plan of Rs. 2150 crores for capital goods imports over the five years so as to comply with the plan phasing of total imports and with the plan provision (among others) that:

> . . . a large part of the deficit is expected to occur in the second and third years of the plan. The "hump" in the middle of the plan

[9] *Second Five-Year Plan*, p. 95.
[10] *Second Five-Year Plan*, p. 95.
[11] *Op. cit.*, pp. 7-13.

TABLE V

Indian Imports by Categories

	Rs. Crores						
	1 1954 Preliminary Estimate in Plan	2 1954- 1955 Actual	3 1955 Preliminary Estimate in Plan	4 1955- 1956 Actual	5 1956- 1957 Anticipated in Plan	6 1956- 1957 Actual	7 Annual Average Anticipated in Plan
I CAPITAL GOODS							
a. Private Sector	N.A.	157.6	N.A.	223.8	114	350.9	N.A.
b. Public Sector	N.A.	N.A.	N.A.	65.2	246	91.1	N.A.
c. TOTAL	172	N.A.	234	299.0	360	442.0	430
II FOODGRAINS	49	N.A.	35	29	45	102	48
III ALL OTHERS							
a. "Raw Materials"	214	N.A.	186	193	N.A.	199	203
b. "Consumer goods"	41	N.A.	50	56	N.A.	68	40
c. Sugar	31	N.A.	20	0	N.A.	0	7
d. "Others"	113	N.A.	130	174	N.A.	266	140
e. TOTAL	399	N.A.	386	423	378	533	390
IV TOTAL IMPORTS	620	684	655	751	783	1,077	868

Note: Row IIIa "Raw materials" includes five categories often show specifically in Indian statistics: Chemicals, drugs, and medicines; oils; dyes and colours; raw cotton; and raw jute.
Row IIIb "Consumer goods" includes two categories often shown specifically in Indian statistics: Paper, pasteboard, and stationery; and Cutlery, hardware, electrical goods and apparatus.
Row IIIc "Others" includes: a large number of consumer goods such as provisions, tobacco and textiles, and of raw materials such as cement, raw wool, rayon pulp and timber, and defense items.

Sources: Columns 1, 3, 7: *Second Five Year Plan*, p. 99.
Column 2: Total (row IV) from *Reserve Bank of India Bulletin*, March 1958, pp. 344-5. Private sector capital goods (row Ia) from *Reserve Bank of India Bulletin*, December 1956, p. 1240.
Columns 4 & 6: *Reserve Bank of India Bulletin*, July 1957, p. 640, except row Ia from *Report on Currency and Finance*, 1956-57, p. 75, and row Ib (see text, p. 190).
Column 5: See text, p. 190.

period is accounted for by the fact that imports of steel, machinery and equipment anticipated in the earlier years of the plan reach a peak about the time the plan is half-way through.[12]

Bhagwati's estimates attributed Rs. 360 crores to capital goods imports in 1956-57, followed by Rs. 445 crores and Rs. 540 crores in the following two years. He also broke down the capital goods figure for each year into its component elements and divided these between the public and private sectors, gleaning such information on intentions as he could from the plan. Of a five-year total of Rs. 1500 crores for machinery and vehicles, the plan specifically allocated Rs. 1050 crores to the public sector and Rs. 450 crores to the private sector. The total of Rs. 430 crores for iron and steel imports was not divided specifically in the plan, but Bhagwati found that four-fifths of this would have to be used by the public sector for the planned steel mills, railroads and irrigation and power projects. He did not believe this to be true, however, for "other metals," of which he estimated almost two-thirds was to go to the private sector.

Although no outsider can tell, especially from this distance, exactly what the planners intended, or whether or not they actually worked out the capital goods needs in this degree of detail, it is difficult, nonetheless, to differ from the general order of magnitudes and ratios which Bhagwati has offered. His conclusions and figures are not reproduced here, except for the subtotals for 1956-57, which form the basis for column 5 of Table V.[13]

The figures for actual public sector capital goods imports (row Ib) are never mentioned in Indian statistics. The figures given here were obtained by subtracting private sector capital goods imports from total capital goods imports, but these two figures, being from different statistical offices, are not strictly comparable.[14] However, the difference is probably at most a few per-

[12] *Second Five-Year Plan*, p. 95.

[13] The only change made in Bhagwati's work is to increase the amount for food imports to Rs. 45 crores for 1956-57 (and hence to decrease the total of "others") so that total five-year food imports will be Rs. 240 crores in accordance with plan requirements for "grains, pulses, and flours." It is not known whether his use of Rs. 215 crores total was accidental or deliberate.

[14] Total figures are from general import figures which are from the Director-General of Commercial Intelligence and Statistics. Private sector figures are from the Exchange Control Division.

centage points and would not materially affect the present discussion.

With these reservations on the accuracy of our figures, we can move to a comparison of the actual 1956-57 level of imports with the level expected in the plan.

(1) Capital goods imports as a whole were only Rs. 82 crores above the anticipated level (and a mere Rs. 12 crores above the annual average). Those of the private sector, however, were more than three times the plan level, while those of the public sector were less than one-third the desired level. Thus imports for the big power and irrigation projects, railroads, and steel mills were evidently lagging behind the expected pace, while their place was being taken by imports of unknown destination in the private sector.

(2) The foodgrains imports were more than twice the anticipated level, which itself was 50 per cent above that of the previous year.

(3) The five specified raw materials imports which remained relatively constant were in keeping with the plan, which stated explicitly that this should be so.

(4) The rise in the two specified "consumer goods" import groups was violating specific plan injunctions that they should be held constant over the five years.

(5) There were evidently negligible sugar imports. This, therefore, represents the only other "shortfall," besides public sector capital goods, of actual imports below expectations.

(6) The "others" category, at Rs. 266 crores was close to twice the plan annual average of Rs. 140 crores. (The expected level for 1956-57 could not have been greatly different from the annual average as the Plan called for only minor increases in this category, mostly for cement imports.)[15]

To summarize: Imports in 1956-57 were Rs. 294 crores above the level anticipated in the plan. Of this, Rs. 82 crores or 28 per cent was in capital goods, Rs. 57 crores or 19 per cent was in foodgrains, and Rs. 155 crores or 53 per cent was in defense, raw materials and consumer goods. These figures are somewhat misleading, however, because private sector capital goods were 200

[15] For this and other references immediately above about plan statements on import levels, see *Second Five-Year Plan*, pp. 99-101.

per cent above the plan expectation and public sector capital goods imports were down 65 per cent from plan goals.

In analyzing this discrepancy between planned and actual levels, a number of factors can be isolated. First, the planners were evidently basing their projections on a rather serious underestimation of the existing level of imports. The estimates printed in the plan for "actual" imports of calendar years 1954 and 1955 were significantly lower in every known category and in totals than the actual levels for the (nearly) corresponding plan years which have since become available. Thus, in setting imports at a total of Rs. 783 crores for 1956-57, the planners were allowing for an increase of only Rs. 32 crores in actuality, but they evidently believed that they were providing for a Rs. 128 crores rise. And, in calling for the "others" category to be at an annual average of Rs. 140 crores, the planners, believing they were allowing for a slight rise from Rs. 130 crores in 1955, were actually unknowingly specifying that imports in this category were to drop by Rs. 34 crores from the 1955-56 level.

Second, statistical evidence was evidently not available to the planners to show the previous split in capital goods imports between the public and private sectors, and of the developing boom in private investment which was demanding these higher levels of imports. Thus, the Rs. 114 crores allocated to the private sector for imports in 1956-57 (this is, of course, a figure not from the planners, but imputed to them from Bhagwati's analysis) was considerably below the actual level for private sector imports for 1954-55, two full years previously. And because of this, the Plan in effect called for a nearly impossible reversal in one year of the ratio of public to private capital goods imports from 1:4 to 2:1. Had the planners been aware of the actual levels of private imports in this category, it seems logical to suppose that they would have either allocated more foreign exchange to the private sector, or called for administrative measures to curtail private investment and capital goods imports, or done both.[16]

[16] There is also some evidence that the total foreign exchange allocation of the Second Plan for capital goods for both public and private sector investments was insufficient for the level of heavy industry investment planned, judged in terms of the First Plan experience. See the study in the *Reserve Bank of India Bulletin,* July 1957 (p. 643), which concludes: ". . . it should be fairly clear that the estimated allowance for imports of capital goods in the Second Plan was not adequate taking into account the magnitude and the investment pat-

Third, there were clearly large gaps between the plan explicit and implicit requirements and the administrative actions which failed to implement or actually contradicted these requirements. Import regulations on a wide variety of items, including not only capital goods but also raw materials and consumer goods, were progressively liberalized up to and through 1956. This was in clear contradiction of the plan explicit statements that imports of raw materials and consumer goods should be held fairly constant, and the requirements that capital goods imports should increase at a moderate rate. Government imports of food were more than double the anticipated level. And, defense imports were increased considerably, although plan silence on this matter coupled with no allowance for increases in the "others" category could only have meant the intention that they remain constant.

The question of what part of the causes of this discrepancy between plans and actions should be laid at the feet of the planners and what share with the administrators must remain outside the scope of this paper. Certainly, it cannot be simply resolved by saying that the plan choices must be said to be the will of the Indian people, and it is therefore totally the "fault" of poor administration. The plan itself may have contained incompatible goals between which choices should have been made but weren't. Further, the plan cannot be regarded as the final word; presumably the Indian people acting through their government could and should at any time decide to alter or ignore its requirements. The judging of this question thus demands a complete study of the Second Plan requirements and assumptions on a host of

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tern of the Plan." The author has checked the figures used in this article, however, and finds them not all comparable as between the two plans. After corrections the conclusion still holds but with less emphasis.

Furthermore, we do not discuss here the important but complex question of whether or not the plan assumption of an over-all capital:output ratio of 2.3 was sound. From the experience of other countries (admittedly the data are poor and suspect and the comparability between countries and time periods unknown) this figure would seem to be too low. From the evidence in Indian reports over the last few months, it would seem to have been found to be too low. Professor Malenbaum suggests that it should be considerably higher in his *A Note on Investment Requirements, Allocations, and Foreign Assistance: India's Second Five-Year Plan* (MIT Center for International Studies, November 1957), p. 16. To the extent that over-all investment requirements were set too low for the goals chosen in the Plan, there was a corresponding underestimation of the total foreign exchange needed for both public and private sectors.

counts, an attempt at evaluating the compatibility of various plan goals and expectations, and, ultimately, the making of value choices between present and future consumption and between various other alternatives (such as defense versus development), which only the Indian people are in a position to decide. All that can be said here is that the plan called for an extremely austere import program which was not carried out in practice.

Finally, it can be pointed out that the developing inflation was an influence on most of the above factors. Thus two bad harvest years followed by drought in some areas in 1956-57 led to both dangerous food shortages and rising prices, and caused Government to begin a massive food inportation program. The rising price trend was very likely a contributing factor to the general air of business confidence which led to an investment boom and the high level of capital goods imports. (And, of course, conversely, this investment boom contributed to the rising prices.) Likewise, the rising prices also served as a stimulant to the demand for consumer goods imports, as did the generally (although slowly) rising level of income in India. Before turning to a more detailed investigation of this inflation, it might be appropriate to point out that had it not been for the high balance of payments deficit and corresponding decline in foreign exchange reserves, which channeled some of the excess demand abroad, the inflation would almost certainly have been much worse.

Inflation

The Indian index of wholesale prices declined sharply in late 1951 and early 1952 from the high Korean war boom level of 1951, and then proceeded to climb slightly and slowly back part of the way up for a little over a year until August of 1953. Surprisingly enough, for the next two years (the third and fourth of the First Five Year Plan) the general trend in prices was downward. In May of 1955 the general index reached a low point, and from there the index rose 29 per cent in 26 months before leveling off in July of 1957. These trends are roughly indicated by the figures in Table VI.

This increase in prices was persistent, rapid, and pervasive enough to be the cause for considerable concern and action by the Government. It was, however, by no means uniform

TABLE VI
Index Numbers of Wholesale Prices
Year Ending August 1939 = 100

	General (100)	Increase	Food (31)	Increase	Indus. Raw Materials (18)	Increase	Semi-Manufactures (17)	Increase	Manufactures (30)	Increase
1950-51	409.7		416.4		523.1		348.9		354.2	
1951-52	434.6		398.6		591.9		374.4		401.5	
1952-53	380.6		357.8		436.9		343.8		371.2	
1953-54	397.5		384.4		467.7		359.2		367.4	
1954-55	377.5		339.8		436.2		350.3		377.4	
1955-56	360.5		313.2		419.8		338.2		372.9	
1956-57	414.0		388.5		501.0		402.3		384.6	
May 1955	342.0	100	276.1	100	396.4	100	329.6	100	374.6	100
May 1956	390.3	114	350.5	127	478.0	120	384.1	116	376.9	101
May 1957	431.2	126	419.3	152	536.3	135	406.5	123	387.7	103
June	439.2	128	433.2	157	541.4	136	413.0	125	392.4	105
July	443.5	129	439.8	159	544.4	137	413.3	125	392.3	105
August	441.8	129	440.9	160	530.6	133	411.2	124	392.7	105
Sept.	435.9	128	424.1	154	525.2	132	409.1	124	394.7	105
October	432.8	127	412.1	149	534.3	135	406.1	123	394.5	105

Numbers in parentheses are weights. "Miscellaneous" with weight of (4) not shown. Columns labeled "Increase" give indexes translated to May 1955 base of 100.

Sources: *Report on Currency and Finance*, 1956-57; and various *Reserve Bank of India Bulletins*.

throughout the economy. The index of food, weighted at 31 per cent of the general index,[17] shot up 60 per cent in 27 months; that for raw materials increased 37 per cent in 26 months. Semi-manufactures prices went up 25 per cent in 25 months. But the index of prices of manufactures rose only a gentle 5 per cent in the same 25 months.

This paper does not attempt to offer a complete explanation for these movements in Indian prices. Rather, some of the more important factors in the Indian economy which have contributed to causing the recent inflation (and to holding it back) are discussed, and where the information is available the statistics on these factors are presented.

Probably the major source of inflationary pressure in the Indian economy has been the vastly increased amounts of deficit financing by both States and Center. Table VII gives figures for the last eight years of shifts in cash balances, increase or decrease in the Center's floating debt, and the purchase or sale of securities by the States. Thus the total figure represents the amount by which the Central and State governments failed to raise sufficient revenues to cover all expenditures (not just those under the Plan). We follow here the Indian usage under which deficit financing refers only to borrowing from the central bank and the drawing down of cash balances. Strictly speaking, therefore, as a measure of deficit financing we should have figures showing not the change in the total floating debt, but only in the holdings of the Reserve Bank of India. If State or Central Government bills are bought by the public, it is equivalent to borrowing in other forms and is not deficit financing, as the term is used here.

As far as the Center's floating debt is concerned, all increases in the past few years have been in the form of Treasury Bills, and the changes in the holdings of others than the Reserve Bank of India are not significant.[18] With regard to the States, it is not known to what extent changes in the holdings of securities have been by others than the Reserve Bank of India. But, it is probably a small amount and very likely insignificant so far as the present discussion is concerned.

[17] A new revised index of wholesale prices, unfortunately not extended back far enough to be used here, weights food at 51 per cent of the total.

[18] *Reserve Bank of India Bulletin*, April 1957, p. 325n.

TABLE VII
Overall Surpluses and Deficits 1951-59 of States and Center
(Rs. Crores)

	1951-52	1952-53	1953-54	1954-55	1955-56	First Plan Total	1956-57	1957-58	1958-59
Decline (—) or Increase (+) in Center Cash Balances	+ 0.9	—63.5	—61.3	— 5.5	— 36.5	—165.9	+ 55.7	— 0.5	+ 5.7
Increase (—) or Decrease (+) in floating debt	+32.2	+17.1	—19.5	—136.8	—123.4	—230.4	—240.5	—380.0	—205.0
Center overall surplus (+) or deficit (—)	+33.1	—46.4	—80.8	—142.3	—159.9	—396.3	—184.8	—380.5	—199.3
Decline (—) or Increase (+) in States' Cash Balances	—10.8	+10.6	— 2.0	+ 13.9	— 51.1	— 39.4	— 60.9	— 25.4	— 14.5
Purchase (+) or Sale (—) of Securities by States	—28.6	—25.4	+20.9	+ 28.3	— 5.9	— 10.7	— 43.8	— 18.3	— 27.2
States overall surplus (+) or deficit (—)	—39.4	—14.8	+18.9	+ 42.2	— 57.0	— 50.1	—104.7	— 43.7	— 41.7
Total states & center overall surplus (+) or deficit (—)	— 6.3	—61.2	—61.9	—100.1	—216.9	—446.4	—289.5	—424.2	—241.0
% of Five-year total*	14.0%	13.7%	13.9%	22.4%	48.6%	100.0%	24.0%	35.0%	20.0%

Sources: *Center*—Figures for First Plan from *Reserve Bank of India Bulletin,* April 1957, p. 325. Figures for Second Plan from Reserve Bank of India Bulletin, March 1958, p. 238. 1957-58 figures are "Revised", 1958-59 are "Budget". *States—Reserve Bank of India Bulletin,* May 1958, p. 502. 1955-56 figures are "Revised Estimates", 1956-57 figures are "Budget", 1957-58 are "Revised", and 1958-59 are "Budget".

* Figures under Second Plan years are percentages of Rs. 1200 crores.

Looking at the totals in Table VII, we see that the over-all deficit rose 60 per cent in 1954-55 to Rs. 100 crores, and then more than doubled in 1955-56 to Rs. 217 crores. In 1956-57 the total deficit increased to Rs. 290 crores and the following year it shot up again, to Rs. 424 crores. Because of the high priority placed on curtailing inflation, only Rs. 241 crores of deficit financing is budgeted for 1958-59. There has thus been a sharp upward trend in deficit financing beginning in 1954-55, so that over two-thirds of the total First Plan deficit financing was in the last two years, and almost one-half was in the last year, of the plan period. And if the actual figures for the first three years of the Second Plan turn out as given here, there will have been Rs. 954 crores of deficit financing out of the total "allocation" of only Rs. 1200 crores for the five years.[10] Thus, Finance Minister Desai was virtually forced to return to the original five-year total of Rs. 1200 crores, despite the fact that his predecessor, T. T. Krishnamachari, had advocated in the fall of 1957 that total deficit financing be limited to Rs. 900 crores.

Three major factors contributed to coercing the Government into such a high rate of deficit financing: rising development expenditures under the plan, rising non-development expenditures, and a shortfall in returns from small savings.

First, Table VIII shows that levels of outlay in the public sector under the plans have indeed been rising, and except for 1956-57, at very sizable rates. They are thus undoubtedly factors, and key ones, in inducing the Government to resort to high levels of deficit financing which has in turn expanded the money supply with the public and led to inflation. But every year these public sector outlays have been below the figure budgeted and presumably below the figure intended in the plan. Certainly the total outlay of Rs. 1960 crores for the First Plan was below the revised goal of Rs. 2378 crores. And, in each of the first three years of the Second Plan, the first estimate has been below the budgeted figure, and later estimates have usually been still lower. Thus, while these high Government outlays are certainly a

[10] The total may have been slightly less. Finance Minister Desai said that total deficit financing for the first two years of the Second Plan had been of the order of Rs. 702 crores (Rs. 12 crores less than the figures in Table VII) in a speech in the Lok Sabha. *Hindu Weekly Review*, April 28, 1958, p. 2.

TABLE VIII

Outlay in the Public Sector Under the Plans

(Rs. Crores)

Year	Outlay	% Increase Over Previous Year	% of 5-Year Total
1951-52	259.4		13.2
1952-53	267.6	3.2	13.6
1953-54	343.0	28.2	17.5
1954-55	475.9	38.3	24.3
1955-56	614.1	29.3	31.3
Total	1,960.0		99.9
1956-57	635.0	3.4	13.2
1957-58	861.0	35.6	17.9
1958-59	960.0	11.5	20.1
Total of first three years	2,456.0		51.0 (of Rs. 4800 goal)

Sources: First Plan—*Review of the First Five Year Plan* (Government of India, Planning Commission, 1956), p. 3.
Second Plan—Estimates only, from *Appraisals and Prospects of the Second Five Year Plan* (Government of India, Planning Commission, May 1958), p. 7.

cause of the inflation, from the point of view of the plan they have been too low. Either the Plan provided for "built-in" inflation, or there are other factors causing inflation which were not called for in the plan. Both are probably true.

Second, non-development expenditures have been rising rapidly (See Table IX), despite or in contradiction to the plan statement that:

> . . . provision has been made for only minimum increase in expenditure under non-developmental heads such as defense and administration. The maintenance expenditure on social services and similar developmental items at the level reached by the end of 1955-56 has also been allowed for, as expenditure of this type is not included in the plan. . . . It is necessary to stress the point that a careful watch on non-developmental expenditure will be necessary in order to obtain for the plan the estimated amount of Rs. 350 crores from revenues at existing rates.[20]

Nor do the figures in Table IX tell the whole story, for they are only three prominent examples which can be identified in

[20] *Second Five-Year Plan*, pp. 78-79.

TABLE IX

Central Government Expenditure on Three Selected Items

(Rs. Crores)

	1955-56 Accounts	1956-57 Accounts	1957-58 Budget	1957-58 Revised	1958-59 Budget
1. Civil Administration	33.57	38.06	43.29	42.84	49.33
2. Defense Services (Net)	172.23	192.15	252.71	266.05	278.14
3. Total of "Non-Developmental Capital Outlay"	—8.58	41.62	179.77	110.73	97.75
Total, these 3 items	197.22	271.83	475.77	419.62	425.22
Increase over 1955-56 (%)		37.8 %	141.2 %	112.8 %	115.6 %

Source: *Reserve Bank of India Bulletin,* March 1958—Rows 1 and 2, Revenue Budget, p. 240; Row 3, Capital Budget, p. 248.

the complex Indian budgets and cited to show the increasing rate of non-developmental expenditures.

This unplanned rise in non-developmental expenditures shows up in another way. The Second Plan called for Rs. 350 crores from taxation at existing rates to be earmarked for developmental expenditures under the plan. It called in addition for tax rates and coverage to be raised sufficiently for another Rs. 450 crores to be provided for developmental expenditures, and provided further that the "uncovered gap" of Rs. 400 crores should also be raised by resorting to internal financing.[21]

According to the *Appraisals and Prospects of the Second Five Year Plan,* sufficient tax measures have been taken to meet these objectives, but with no gain for the plan:

Taking the Center and the States together, the five-year yield of the additional tax measures adopted in these three years thus works out at Rs. 900 crores, which, in itself, meets fully the target of Rs. 450 crores in the Plan, *plus* the uncovered gap of Rs. 400 crores.

All of this tax effort has, however, not provided resources for the Plan; a large part of it has been absorbed by other demands; defense, non-development expenditure, and development expenditure outside the Plan.[22]

Third, government income from small savings and market loans has been considerably below the plan goals. The Second

[21] *Second Five-Year Plan,* p. 78.

[22] *Appraisals and Prospects of the Second Five-Year Plan* (Government of India, Planning Commission, May 1958), p. 12.

Plan called for the raising of Rs. 700 crores (net) over the five years from market loans (an average of Rs. 140 crores per year) and Rs. 500 crores in five years in small savings. Thus these two sources together were counted on to raise Rs. 240 crores per year, on the average. In 1955-56 the total amount taken in (net) was only Rs. 101.15 crores, in 1956-57 it rose to Rs. 136.72 crores, and in the 1957-58 revised figures it stands at Rs. 128.21 crores. Despite a variety of new forms and lengths of possible loans, and other inducements offered by Government, it seems doubtful that the 1958-59 budgeted figure of Rs. 225 crores will be reached, or that the plan goals can be approximated.

Private credit expansion over the past several years has been a parallel source of inflationary pressures, along with the increasing deficit financing of Government. Figures available here on private credit are not in a form to give a clear picture of the trends in total credit. However, one indicator, the advances by scheduled banks for industrial purposes, increased by Rs. 4 crores in 1953-54, Rs. 48 crores in 1954-55, Rs. 59 crores in 1955-56, and Rs. 90 crores in 1956-57.[23] Many other statistics, such as the advances of the Reserve Bank of India to Scheduled Banks, indicate a sharply rising amount of private credit, beginning about 1954-55. There are also some signs that the rate of expansion leveled off somewhat in 1956-57.[24]

In contrast with the expansionary effects of public sector deficit financing and private sector credit expansion, which have been increasing over the past several years, the balance of payments changed from being a mildly inflationary influence to one of a very strongly deflationary nature in 1956-57. Of the last four years of the first plan period, only in 1954-55 was the balance of payments deflationary, and then the decline in foreign exchange reserves was only Rs. 17 crores. In each of the other three years the reserves increased, but in such a small amount that the influence of the balance of payments might well be called negligible. But in 1956-57 with a net reserves decline of Rs. 246 crores, the balance of payments exerted a major deflationary force on the economy. The 1957-58 drain on reserves will prob-

[23] K. N. Raj, *Planned Development in a Mixed Economy: An Appraisal with Reference to India, 1951-57* (unpublished mimeographed manuscript dated December 4, 1957), p. 22. Raj does not cite his source.

[24] See *Report on Currency and Finance*, 1956-57, pp. 26-29.

ably total about Rs. 269 crores when comparable figures become available.[25]

The influences of Government deficit financing, private credit expansion, and foreign exchange reserves changes on the national economy are felt, and to a certain extent are measurable, through the change in money supply with the public. However, money supply changes are not, of course, directly reflected in price changes. To assume this would be to assume such things as a constant total supply of goods and services, a constant velocity of circulation of money, and no change in the degree of monetization of the economy. None of these is likely to approximate constancy.

India's money supply with the public has been increasing during the past years (see Table X, rows 6 and 7), with the largest increases (in percentage terms) coming in 1954-55 and 1955-56 (the 1956-57 increase was slightly larger, absolutely, than that of 1954-55, but as a percentage of total money supply it was smaller). However, to the extent that these increased volumes of money were needed for a growing supply of goods and services and for more widespread use of money, this need not have been inflationary.

India's national output[26] has been increasing steadily (but not at a constant rate) every year in recent years (see Table X, rows 8 and 9). When the increase has been small, but the increase in money supply large, there has been a considerable pressure on prices. This relationship is particularly true in India, not alone from the viewpoint of overall demand and supply, but because

[25] Recent *Reserve Bank of India Bulletins* show a decline in foreign exchange assets for 1957-58 of Rs. 234.3 crores. However, they have changed their tables, and now give only the one amount in place of gross assets, liabilities, and net assets as formerly. Moreover, figures given, and declines computed therefrom, do not exactly correspond with figures for the same months from the earlier series. Assuming this to be not a net, but a gross figure, Rs. 34.5 crores paid to the IMF for dollars in June 1957, has been added here, making a total deflationary drain of Rs. 268.8 crores. This figure, however, may be low, as Sterling, which declined Rs. 219 crores in 1956-57, was said to have dropped Rs. 481 crores in the 2 years (in a speech by the Governor of the Reserve Bank, see *Reserve Bank of India Bulletin*, June 1958, p. 640). This would mean a 1957-58 Sterling drop of Rs. 262 crores, or with the IMF loan added in, a total drain of Rs. 296.5 crores. For the time this will have to remain one of the many unsolved mysteries of Indian statistics.

[26] In recent years India's net national output has been equal to net domestic product at factor cost, and these are considered in the statistics to be equivalent to national income.

TABLE X

	1952-53	1953-54	1954-55	1955-56	1956-57	Est. for 1957-58
1. Public Sector Outlay under Plan (RsCr)	267.6	343.0	475.9	614.1	635.0	861.0
2. Increase over previous year (%)	3.2	28.2	38.3	29.3	3.4	35.6
3. Overall deficit of Center and States (RsCr)	— 61.2	— 61.9	—100.1	—216.9	—289.5	—424.2
4. Increase over previous year (%)		1.1	62.0	117.0	33.5	70.0
5. Change in foreign exchange reserves during year (RsCr)	+185.0	+ 31.0	— 17.2	+ 15.0	—246.0	—269.0
6. Change in money supply with public during year (RsCr)	— 39.0	+ 29.0	+127.0	+264.0	+129.0	+ 75.0
7. Per Cent change in total money supply during year (%)	— 22.0	+ 1.6	+ 7.1	+ 13.7	+ 5.9	+ 3.2
8. Net National Output (RsCr)	9,470.0	10,030.0	10,280.0	10,480.0	11,010.0	
9. Increase over previous year (%)	3.8	5.9	2.5	1.9	5.1	
10. Production of foodgrains (in tons)	58.3	68.7	66.6	65.3	68.7	
11. Index of wholesale prices for May *following* plan year, e.g., figure under 1952-53, is for May 1953	397.4	396.1	342.0	390.3	431.2	422.0

Sources: Rows 1 and 2, Table XIII; Rows 3 and 4, Table VII; Row 5, Table I and text, p. 202; Rows 6 and 7, *Report on Currency and Finance*, 1956-57, Statement 21, pp. 114-5 and *Reserve Bank of India Bulletin*, June 1958, p. 722; Rows 8 and 9, *Review of the First Five Year Plan* (Government of India, Planning Commission), pp. 7-8 and *Hindu Weekly Review*, April 7, 1958; Row 10, *Agricultural Situation in India* (Government of India), Jan. 1958, p. 1183, and *Report on Currency and Finance, 1956-57*, p. 103. (Figures are for years ending in June); Row 11, various *Reserve Bank of India Bulletins* (1957-58 figure is a projection).

India's national product is roughly one-half agricultural, and the price trends we have been analyzing here are largely determined by agricultural prices. Thus when the growth in net national output has been large (as it was in 1953-54) it has been mainly because of a good food crop (see Table X, row 10), and unless this influence has been over-balanced by some inflationary pressures the result has been a downward movement in prices. On the other hand, when crops have been bad, as they were in 1954-55 and 1955-56, the growth in net national output has been low, and the pressures on prices have been upwards. Thus India's price level is peculiarly susceptible to variations in the domestic production of agriculture. (And so long as Government is committed to importing sufficient food to hold prices down this makes the balance of payments likewise susceptible to unpredictable demands.)

The data presented and discussed above are brought together for comparative purposes in Table X. It should be emphasized that this by no means includes all of the major elements directly influencing recent price trends in India. No figures are included, for example, on private credit expansion, nor on private savings or private investment. Nor is any evidence offered on the influences on these items of government monetary policy, which has been directed recently toward contracting the expansionary forces and thus to dampening the inflation. (These pressures are to a certain extent, however, mirrored in the changing money supply.) Finally, no analysis has been made of the influences on the Indian economy of the generally rising price trends in other countries.

Nonetheless, it would seem to be possible to use the data in Table X to make a tentative analysis of the recent history of price changes in India. Although public sector outlays under the plan increased strongly in 1953-54 and 1954-55, they had to be only partly covered by deficit financing, which remained at a fairly low level. The balance of payments in both years was relatively neutral and a bumper food crop in 1953-54 provided ample supplies, some of which were probably carried forward and helped to cushion a poor crop in 1954-55. The result was a downward movement in prices, despite a sizable increase in money supply with the public in 1954-55.

But for the next two years the pressures were very strongly inflationary. All of our factors pointed to a price increase in 1955-56. Public sector outlay was again considerably increased and deficit financing shot up 117 per cent to Rs. 217 crores. Even the balance of payments was mildly inflationary that year, and the result was that money supply went up an unprecedented 13.7 per cent. This was coupled with a decline in food production and a consequent very small rise in national product. These indicators show continuing, though somewhat lessened, inflationary pressures in 1956-57. Public sector outlay and deficit financing were up still more. These were, however, coupled with the very strong and sudden deflationary influence of the balance of payments deficit. The result was a sizable but smaller increase in money supply with the public. And, although early reports indicated a very poor crop year, the total food production is now reported to have once again regained the level reached in 1953-54, and consequently net national output showed a marked increase.

Prices have leveled off and even declined somewhat from mid-1957. The information available here at this time is not yet sufficient to frame a full explanation of this change. The two dominant influences were probably the continued strong deflationary effects of a large balance of payments deficit and the increase in availability of food, both because of good crops and because of the large program of Government imports. Unexplained, though, by this analysis is the evidently very small increase in money supply with the public during 1957-58 in the face of what must have been an extremely high rate of deficit financing by government. Perhaps the figures for private credit expansion, if available in useable form, would provide a partial explanation.

Summary and Conclusion

Towards the end of the First Plan and early in the Second, the Indian economy ran full tilt into the twin nemeses of development: inflation and rapidly declining foreign exchange reserves. This paper has presented a compilation and discussion of some of the data available here which might throw some light on the nature and causes of these problems.

The two problems have been found to be interrelated in a variety of ways. In the first place, they have in common some

causal factors; for example, unfavorable weather conditions and a corresponding food shortage, the increasing rate of government expenditures both within and outside the Plan, the private sector investment boom, and the growing demand of people for consumers goods, all probably contributed to both growing imports and rising prices. In the second place, the inflation itself undoubtedly added to the balance of payments crisis, inasmuch as it certainly stimulated the demand for a wide variety of imports, and it may have been a factor in curtailing exports. And finally, the drain on foreign exchange reserves was a major deflationary force and helped to curtail the inflation.

It has been shown that the inflation, and to a lesser extent the balance of payments crisis (contrary to frequently heard opinion) were well underway at the end of the First Plan.

We have found that the import statistics upon which the Second Plan was based were both late and inadequate, with the result that the plan called for shifts in import trends which were neither known to the planners nor spelled out explicitly, but which tended to upset from the beginning the plan import expectations. Further, although this paper has not attempted to analyze the realism of the Second Plan (except with regard to the statistics available to the planners), the conclusion can be reached that certain requirements of the plan (most notably the need for a high level of deficit financing) probably contributed to the continuance and development of the two problems under discussion.

But probably the most important causes of difficulty have been the discrepancies between what the plan called for (or implied) and the actual actions taken by Government, such as the relaxation of import controls, the increasing of non-Plan expenditures at a rapid rate, the importation of large quantities of food and defense items, and the failure to take into account or control the boom in private sector development. No attempt has been made to argue here which of these needs and actions should have been predicted and allowed for in the plan, which might have been foregone in the interests of successful development, and which might not have been predictable but were important enough to make exception for after they arose. The final answer to such questions must, of course, come from the operations of the political processes in a democracy.

THE SOVIET VIEW OF THE INDIAN ECONOMY

*Leonard Joel Kirsch**

Introduction

In recent months the "economic competition for the uncommitted nations" between the United States and the Soviet Union has attracted much attention. According to a United States State Department résumé, from 1955 through 1957 the Sino-Soviet Bloc extended some $1.5 billions in financial aid for non-military purposes to the underdeveloped countries outside the Soviet bloc.[1]

Why has the Soviet Union undertaken this program? What is its scope? What form will the aid take? What is the potential of the Soviet economy to extend aid? What is the degree of Soviet understanding of the economies of the countries to which aid is being given? In this study we will suggest some answers to the last of these questions as applied to the development of the Soviet economists' views of the economy of India which has received $270 millions[2] in Soviet financial aid in the period in question.

It may be, of course, that Soviet leaders make their decisions about aid on a strictly political and propagandistic basis, and therefore the views of the Soviet economists are irrelevant. Even if this were true (and it is doubtful), a study of Soviet economic analysis of India should prove interesting if only for the light shed on Soviet economic thought concerning underdeveloped areas.

To some Western economists much of what is to be said may seem to belong properly to the field of political science rather than to that of economics. Whatever the merits of such a position, the Soviet economists have marked out the field of study in accord with their Marxist idea of the scope of economics, i.e.:

> . . . the science of the laws governing the production and exchange of the material means of subsistence in human society. And it is

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[1] As quoted in *The New York Times,* January 15, 1958, p. 4.

[2] *Ibid.*

the development of the mode of production and exchange, i.e., the economic development of society, which is the basis of the whole social development.[3]

For the purposes of this essay, we accept this definition.

There is a paucity of Soviet writings analyzing the Indian economy. From Stalin's death in 1953 till approximately mid-1955, material on the subject was virtually non-existent. On the other hand, during the past year, material has become relatively abundant. For the most part, the sources here used are from books and journal articles written by Soviet economists, none of whom is among the better-known figures. Throughout this study we will work on the assumption that the bulk of Soviet analysis can be found in published material.

In the first section I will discuss Soviet views on the Indian economy during the "Stalinist" period, and in the following section, the views expressed in the "post-Stalin" or Khrushchev period. The concluding section evaluates Soviet economic thought concerning the Indian economy.

The Soviet Economists' View of the Indian Economy Prior to 1953

The Soviet view of the Indian economy during this period is much like that taken by the majority of economic historians who might be considered as anti-imperialist.[4] Only two aspects of Soviet analysis demand comment.

First, when discussing this period, the Soviet economists place major emphasis on the perfidy of the English. Little attention is paid to the fact that in terms of Marxist theory, the intrusion of the advanced English economic system, while causing the destruction of the traditional modes of production, also "produced the greatest, and to speak the truth, the only social revolution in Asia."

England, it is true, in causing a social revolution in Hindustan, was actuated only by the vilest interests, and was stupid in her manner of

[3] Cornforth, Maurice, *Readers' Guide to Marxist Classics* (London, 1952), p. 31.

[4] For an example, see: D. R. Gadgil, *The Industrial Evolution of India in Recent Times* (London, 1942), (4th edition).

enforcing them. *But that is not the question.* The question is, can mankind fulfill its destiny without a fundamental revolution in the social state of Asia? If not, whatever may have been the crime of England, she was the unconscious tool of history in bringing about that revolution. *(emphasis added)*[5]

Unfortunately, the Soviets do not give an answer to Marx's "question" in so many words, yet they definitely infer that without British intervention India would have developed into a unified capitalist country without having to pay as gigantic a cost.[6]

A second major point that Soviet economists stress is that once British rule was established, the seeds of its own destruction were planted, i.e., the growth of capitalist industry in India. With British rule, "owing to the laws of historical development, the objective premises for the development of capitalist industry in the country was created."[7]

As a result of her colonial position, the industrial development of India took on certain characteristics that play a key role in all Soviet analysis of the Indian economy. Most important was that the major branches of industry were developed by the English for English markets, and therefore, "from its very beginning, national industry came to be dependent upon English capital."[8]

Another result of the country's dependent position was the lack of development of heavy industry. According to Soviet economic theory, under capitalism heavy industry begins to develop only after the establishment of consumers' goods industries.[9] In India, this "law" attains greater applicability because of the country's colonial status. Producers' goods industries suffered not only because of the normal course of capitalist development, but also because native heavy industry would have to compete with its more advanced British counterpart, and because of the

[5] Marx, Karl, "The British Rule in India," (1853) in *The Selected Works of Karl Marx* (New York, no date), vol. ii, pp. 655-56.

[6] An interesting statement of this idea is also made by an American Marxist, Paul A. Baran, in his *The Political Economy of Growth* (New York, 1957), pp. 146-50.

[7] Mel'man, S. M., *Ekonomika Indii i Politika Angliiskovo Imperializma* (The Economy of India and the Politics of English Imperialism). Published by the Academy of Science of the U.S.S.R. Moscow, 1951, pp. 26-27.

[8] *Ibid.*, p. 53.

[9] *Politicheskaia Ekonomiia,* Institute of Economics of the Academy of Sciences of the U.S.S.R., Government Press of Political Literature, Moscow, 1953, pp. 413-436.

general desire of the English to keep Indian industry dependent upon the home country.[10]

For the Soviet economists, the economic development that took place between the beginning of World War I and the end of World War II caused no basic changes in the structure of the Indian economy. While the relatively large-scale industrialization that took place in India during this period is not denied, the basic explanation for this development is in terms of it being somewhat of an aberration of colonial development caused by the emergency of the two World Wars.[11] Three major results of this industrialization are stressed by Soviet economists.

First, a widening of the role of native capital in the economy, notably in the factory industries. The British government needed a more productive India in her war efforts, but British capital was not in a strong enough position to provide the necessary capital. Native capital was therefore called upon, or rather permitted to play a larger role.[12]

Second, Indian industry became much more centralized geographically and financially. The geographical centralization was called forth by the nature of an economy producing primarily for export, i.e., most development taking place in or around port cities. In finance, the wealthy native bourgeoisie, a small group that had gained its strength primarily through comprador activities, was in a position that enabled it to control completely all industrialization that was created by native capital.[13]

The third result is tied to the second, that is, with the centralization of industry there was a concentration of the working force. As was the case in Russia prior to the Revolution, the number of workers per major enterprise was much greater than the over-all conditions of the economy might indicate. This concentration of a nation's working force "undoubtedly has a great significance for the growth of the political consciousness and the organization of the working class."[14]

The industrialization that did take place due to the two World

[10] Mel'man, *op. cit.*, p. 24.
[11] "India," *Bol'shaia Sovetskaia Entsiklopediia* (The Large Soviet Encyclopaedia) Government Scientific Press, Moscow, 1953, p. 42.
[12] Varga, E., *Mirovoe Khoziaistvo v 1936 g* (World Economics During the Year 1936), Government Social-Economic Press, Moscow, 1937.
[13] *Ibid.*, p. 42.
[14] *Ibid.*, p. 53.

Wars meant even greater sacrifices for the working class. When considering this period, we find three specific reasons for the "special force" with which the "law of absolute and relative impoverishment of the working class" applied in India. First, the very development of capitalism produces this phenomenon. Secondly, the law applies more sharply because the development takes place in the time of "the general crisis of capitalism." Unfortunately, the exact relationship between this "general crisis" and the impoverishment of the Indian working class is not developed. Finally, as before, the colonial status of the country places an additional burden on the working class.

All of Soviet economic analysis of Indian agriculture is closely tied up with the idea that although the British introduced capitalism into the Indian economy, they also strengthened the role of indigenous Indian feudalism. The colonial government consciously nurtured feudalism in the Indian village by formalizing and extending traditional "tenant-lord" relations. "Capitalist exploitation [peasant selling his labor] in the Indian village not only did not liquidate the middleman methods of exploitation, but redoubled them. The feudal agrarian system in India rose up under the direct influence of the colonial government."[15]

Under these conditions, the Indian peasant was subject not only to extractions from the agricultural sector of the economy called forth by "primitive accumulation" of developing capitalism, but he was also forced to continue payments to the landowning class which would be appropriate under feudalism. These payments, impoverishing the peasant, caused greater concentration in land holding.[16] Within this context, the Soviets explain the intense and worsening hunger that supposedly served as a characteristic of the Indian economy at least until 1953.

Even with the conclusion of World War II, improvement of the agricultural situation was regarded as impossible within the existing form of the government. For, not only were the English committed to support the large landowners, but "The Indian national bourgeoisie, to a significant degree closely tied to the big landowners and usurers, were not able to radically raise the ques-

[15] *Bol'shaia Sovetskaia Entsiklopediia* (The Large Soviet Encyclopaedia), p. 44.

[16] Mel'man, *op. cit.*, pp. 13-21.

tion of agricultural reform."[17] Nehru, as a representative of the large bourgeoisie, is able to present land reform measures that are, at best, considered "half and half." His proposal for compensation to landowners, for the Soviet economists, exposes the nature of these reforms.[18]

For the Soviets, Lenin's expectation of increasing struggles among capitalist nations for colonial territory and markets was especially valid in the case of India. Starting with the end of World War I, England's share of the Indian market declined. While the Indian market was becoming more important to England due to her general worsening position in the world market, the United States and Japan were increasing their share. In the "struggle for India as a market and as an object for robbery," England was losing, up until World War II.[19]

During this period, another change was taking place in India's role on the world market, that is an increasing share of her agricultural produce was being exported. Two factors supposedly caused this condition. First, the Indian internal market for native as well as foreign products was continually being limited by workings of the "law of relative and absolute impoverishment of the working class." This "law" was reflected in foreign commerce because as the share of profits increased, as opposed to wages, a large percentage of national income went out of the country in the form of profits, and thereby limited the purchasing power of the Indian market. A second factor, closely tied to, yet distinguishable from, the first, was the simple increased physical effectiveness of the exploitation of Indian raw materials by the imperialist powers.[20]

The most interesting, and most heavily stressed, point in the Soviet economists' analysis of the Indian economy is the development of class relationships in India. Excluding the activities of the English, much of India's economic development is explained in terms of the positions of the three major classes in the country, i.e., the feudal-landowning class, the working class and the native Indian bourgeoisie.

[17] Gurvich, R., "Hunger in India, and the Indian Peasantry," *Mirovoe-Khoziahstvo i Mezhdunarodnaia Politika,* July-August, 1946, no. 7-8, p. 92.
[18] *Ibid.,* p. 93.
[19] Mel'man, *op. cit.,* p. 176.
[20] Varga, *op. cit.,* p. 115.

When the English took political control in India, they strengthened and nurtured indigenous Indian feudalism to find the support necessary for the continuation of their rule.[21] The class interests of these feudal elements were one with the interests of English imperialism. These most reactionary elements in Indian society stood in direct opposition to the most progressive —the working class.

Although the working class constituted only a small proportion of Indian society, three special features of Indian economic history give it an especially important role. First, as was already mentioned, the working class was highly concentrated. This in turn produced a degree of class consciousness which was much greater than might otherwise be expected.[22] Secondly, the level of class consciousness of the working class was increased as they became inspired by the establishment of the Soviet regime in Russia, and "The popular masses in India became enriched by this great political experience."[23] Finally, the Indian working class was in a relatively strong position *vis-à-vis* the native bourgeoisie. While the British provided a good portion of the entrepreneurs, the working class was made up almost totally of Indians, and therefore the strength of the native proletariat developed faster than that of the native bourgeoisie.[24]

Like the proletariat, the Indian bourgeoisie did not exist in pre-British India. It "took form as a class only in the nineteenth century."[25] Although it sprung up under British rule, unlike the feudal elements, its interests were to some extent in conflict with those of the English. It could gain control of the economy of the country only at the cost of British imperialistic interests, but for a number of reasons it did not directly challenge foreign rule. Its role is not nearly as clear cut as that of the working class or the feudal class, and much of Soviet economic analysis rests upon various evaluations of the role of this group.

[21] Mel'man, *op. cit.*, p. 106.
[22] *Ibid.*, p. 53.
[23] Balabushevich, V. V., "The Working Class and the National Liberation Movement in India from 1923 to 1927," *Uchenye Zapiski Instituta Vostokovedeniia*, vol. X, p. 8.
[24] Mel'man, *op. cit.*, p. 24.
[25] Grashe, V. iA., "A Short Coverage of the Formation of Large Industrial Capitalists in Colonial India," *Uchenye Zapiski Instituta Vostokovedeniia, vol.* X, p. 99.

Up until World War II, the native bourgeoisie was regarded as being too weak to play any role other than that of "lackey" of English rule. It desired the continuation of this rule for it feared that without the English, the working class would take power. On the question of the role of this group during and after the War, Soviet economic discussion becomes somewhat more lively with two conflicting interpretations.

During the war, India ceased to be England's debtor and became her creditor. In the first few years after the war, Soviet economists viewed this change basically as showing that the role of the Indian nation was gaining in strength *vis-à-vis* English capital. This position was expressed by the well known Soviet economist, E. Varga,[26] as follows:

The transition of India from a debtor of England indicates an extremely serious change in the economic relation of these two countries, and moreover, the change is to the advantage of India.[27]

For Varga, this transition aided the financial, and at least to a significant degree, the political independence of the Indian bourgeoisie. This, in turn, signified a strengthening of the movement for Indian political and economic independence.

By 1950, the Varga analysis of the situation in India was repudiated. The economist S. M. Mel'man attacks Varga by name as follows:

English official representatives and the English bourgeois press; in order to cover the imperialist character of the taking of material resources from India, put forward the formula:

India–creditor, England debtor.

It is proper to point out that E. Varga repeated this same formula.

[26] It seems pertinent to this discussion to note that Varga was possibly the leading Soviet economist until he took an "incorrect position" in the "Varga debate" of 1947. He maintained that for the capitalist world, and notably the United States, a major depression was not imminent. In the 1953 edition of the three volume *Entsiklopedicheskii Slovar'* (*Encyclopaedic Dictionary*), Government Science Press, Moscow, vol. i, pp. 258-59, Varga is referred to as a "Soviet economist" who has admitted serious errors, which were exposed to criticism and recognized by their author."

[27] Varga, E. S., *Izmeneniia v. Ekonomike Kapitalizma v. Itoge Vtoroi Mirovoi Voiny* (Changes in the Economy of Capitalism as a result of the Second World War), Government Press of Political Literature, Moscow, 1946, p. 222.

Not having investigated the essence of the situation, only having grabbed hold of its surface, E. Varga advanced a deeply mistaken emphasis concerning the accumulation of sterling credits by the Indian Reserve Bank and the liquidation of the Sterling debt in the years of the War . . .

Indeed, the formation of Sterling accumulation on India's account and the liquidation of her Sterling debt appears as an expression of a more disguised method of colonial robbery of India by English imperialism.[28]

Mel'man maintains that the liquidation of the debt just shows that England had taken more resources from India, and in addition, the Sterling reserves had little meaning for the Indian economy because the Reserves could not be used as India saw fit.[29]

Although Mel'man admits that the share of native capital in the economy increased during the War, "the governing position in all branches of industry remained with the British."[30] Aside from their close ties with imperialism, the wealthy Indian bourgeoisie are made an even more ineffectual independent force because they are united with the feudal elements in the economy. This latter proposition is proven by citing the partial ownership of large shares of industrial firms by the more wealthy of the Indian princes.[31] The English supposedly recognized their unity of interest with the wealthy bourgeoisie by the formation in 1945 of joint stock companies which strengthened the ties between the English and the Indian monopolists ". . . in the struggle against the national liberation movement."[32]

A later post-Stalin analysis of the "India-creditor" problem was presented by the economist N. D. Grodko in 1955. He held that the idea that India had in reality changed into a creditor nation was "completely not in accord with the facts." In the first place, the English debt to India was frozen and India could not therefore use it as she saw fit. At the same time, English investment in India was at the complete disposal of British capitalists. Secondly, India did not on the whole receive interest on her debt until 1947,

[28] Mel'man, *op. cit.*, pp. 171-172.
[29] *Ibid.*, pp. 174-75.
[30] *Ibid.*, p. 146.
[31] *Ibid.*, p. 148.
[32] *Ibid.*, p. 154.

and from that time the interest was only 0.5 per cent. In contrast, during the same period, English capitalists received "great profits which often reached percentages calculated in the tens."[33]

For the Soviet economist, the problem whether India had truly turned into a creditor nation was not purely academic. It involved the whole question as to the degree of strength and independence the Indian bourgeoisie had *vis-à-vis* the English. This in turn involved the nature of the Congress Party which was supposedly basically controlled by these bourgeoisie. From Mel'man's analysis of the national bourgeoisie, the movement for "nominal" independence led by the Congress Party is viewed as just another stratagem of imperialists. Mel'man views the base of a "true" national liberation movement to be almost solely the working class "under the leadership of the Communist Party."[34] Neither "national liberation" nor economic progress could be expected under the existing governmental structure.

On August 15, 1947, the authority of the British government in India ceased. During the same year, those areas with a majority of Muslim population were separated to form the State of Pakistan. For the Soviets, at least until the death of Stalin, the latter event was considered much more important. In fact, 1947 was referred to not as the year of Indian independence, but the year of the "division." The terminology is appropriate to the Soviet view that in spite of "nominal" independence, the nature of the Indian economy did not change.

The gaining of independence by the Indians is viewed as simply a British tactic to defeat the real "national liberation movement." With the rise of peasant and worker opposition, often taking violent form, England decided to retain its position in India by a "more masked" control of the country:

Not feeling that it had power to hold India in the form of a "classical" colony, English imperialism through various means was compelled finally to turn away from methods of direct rule of India, and to allow the rule of the old exploiting classes of India . . . to create and use a block of reactionary power within the country for the struggle against the masses.[35]

[33] Grodko, N. D., "From the History of the Government Debt of India," *Uchenye Zapiski Instituta Vostokovedeniia,* vol. xii, p. 287.
[34] Mel'man, *op. cit.,* pp. 256-268.
[35] *Ibid.,* p. 205.

Although the division was a "stratagem," for the Soviet economist it was also an example of the increasing strength of the influence of the United States, which was making great gains in the "struggle for India." The American Lend-Lease Law provided "a means for the strengthening of its penetration into India."[36] Then finally, the U.S. supported the granting of "nominal" independence as a means of "playing up to the large Indian bourgeoisie."[37]

The Soviets also have an economic analysis of the doctrine that acted as prime mover in the Indian attempt to gain independence—that of Mahatma Gandhi. For the Soviets, the economic content of the Gandhi doctrine was unscientific and socialist only within quotation marks. "Socialism for all classes, the exploiters and the exploited" was completely unacceptable. The true economic base of Gandhism may best be seen by the fact that on a number of occasions Gandhi himself told workers to put down their arms during strikes that were anti-imperialist in content. Therefore it was obvious that the imperialists were able to make use of Gandhi's philosophy for their "own selfish interests."[38]

Aside from the Soviet view of the class nature of the doctrine, it was also viewed as in conflict with the inevitable process of industrialization. The general line is similar to that taken by Lenin in his struggle with the "*Narodniki*" in Russia prior to the Revolution. Gandhi's emphasis upon the traditional native modes of production is unrealistic in that it regarded modern industry as a "small corner" of the economic system. Massive industrialization, and not a return to tradition, is the only way for India to ever gain real independence.[39]

For the Soviets, those forces, both internal and external, which had worked for the division were anachronistic or imperialistic, and offered no hope of a "progressive" India. The key features of the economy—imperialist control, unbalanced industrialization, and feudal "remnants" in control of agriculture—remained.

[36] *Ibid.*, p. 179.
[37] *Ibid.*, p. 153.
[38] Vakar, S. M., "The Class Nature of the Gandhi Doctrine," *Voprosy Filosofii*, Moscow, no. 3, 1948, pp. 266-79. A condensed translation of this article may be found in the *Current Digest of the Soviet Press*, vol. i, no. 37, pp. 3-7.
[39] Mel'man, *op. cit.*, pp. 23-25.

Some minor aspects of the economy had changed, but on the whole,

> English capital continues to occupy a commanding position in the Indian economy. Naturally, because of the war this position significantly weakened; the share of national Indian capital grew. Not to recognize this process would be incorrect. At the present time the large banks as well as the so-called managing agencies are extending their influence in many branches of the economy.[40]

Living conditions of the mass of the population continued to decline. Unemployment continued to grow, and, worst of all, inflation had reached a "catastrophic degree." The inflation, in addition to denying the population the ability to "satisfy their most urgent consumption needs," meant a decline in India's position in the world market and thereby helped cause industry and agriculture to "suffer stagnation and decline."[41]

For the period under consideration, it is difficult, if not impossible, to find a program that could be called a Soviet program for Indian economic growth. In works written during this period, Soviet economists implicitly, if not explicitly, find the general proposals put forward on economic matters by the Indian Communist Party to be excellent.

There is one Soviet proposal which is not referred to as part of the program of the Indian Communist Party. It is that,

> The increasing of the planted area under grain crops must be brought about at the cost of cropping with unplanted land, and the reduction of land under technical crops.[42]

This is a specific example of what seemed to be the Soviet economist's time horizon concerning the Indian economy, i.e., stop-gap measures for reducing hunger at the present time while a general program for economic growth is pushed off until the political base for over-all socialist planning is established.[43]

[40] Balabushevich, V., "India after the Partition," *Mirovoe Khoziahstvo i Mezhdunarodnaia Politika,* Moscow, no. 12, 1947, pp. 41-61.

[41] *Large Soviet Encyclopaedia,* p. 44. It might here be noted that in dealing with the subject of inflation, Mel'man recognizes that it was less than during the years of the Second World War, while the Encyclopaedia simply finds it to be "catastrophic."

[42] Gurvich, *op. cit.,* p. 89.

[43] Although not stated in so many words, Mel'man as well as Gurvich definitely give the reader this impression.

Soviet Economic Analysis of the Indian Economy After 1953

Unlike a change in some specific aspect of Soviet foreign policy, it is all but impossible to determine the exact time when Soviet economists changed their view of the Indian economy. There is a paucity of published Soviet material concerning the Indian economy. Following the death of Stalin, this literature became almost nonexistent, and then, during the past year or two, articles began to appear at an increasing rate. Yet, in spite of this gap in the literature, we find that the general line regarding the Indian economy as imperialist-controlled died with Stalin.

There are two key concepts in the Soviet economists' approach to the Indian economy since the death of Stalin. The first of these is Lenin's "many roads to socialism."

> All nations go toward socialism, this is inevitable, but all do not go in the same way, each carries individuality in this or that form of democracy, in this or that variety of dictatorship of the proletariat, in this or that tempo of socialist transformation of different sides of social life.[44]

India is thus on her way to socialism in "this or that way" in all respects except that she has neither "this" nor "that" form of dictatorship of the proletariat. The lack of a dictatorship of the proletariat calls forth the second major concept in the Soviet approach to the Indian economy, that is, the positive nature of a large share of industry under government ownership:

> As was emphasized by Lenin, Government Capitalism is a step to socialism, especially in a country dominated by small industry.[45]

In Soviet economic writings on India, these two concepts seem to merge, and we get a general picture of India travelling on her road to socialism by means of Government Capitalism.

In their new approach to the Indian economy, the Soviets do

[44] Quoted in: *Razvitie Ekonomiki Stran Narodnoi Demokratii Azii,* (The Development of the Peoples' Democracies of Asia), Vneshtorgizdat', Moscow, 1956, p. 4.

[45] Rubinshtein, M. N., *Ekonomicheskoe Razvitie Respubliki Indii,* (Economic Development of the Republic of India), pamphlet from Series 7 of "Znanie," no. 15 and 16, Moscow, 1956, p. 18.

not attack their earlier analysis as incorrect. The more recent analysis finds that from the gaining of Indian independence (no longer "the division") until about the Second Indian Five Year Plan, general conditions were not favorable for economic growth. As before, the major hindrance to economic growth was foreign control.[46]

Comment on the First Indian Five Year Plan is extremely sparse, but one commentator presents his analysis of the Plan as follows:

The First Five Year Plan of India in fact was not an economic plan in our understanding of the word, but mainly a forecast of capital construction (called "projects" in India) basically in agriculture and energy . . .

The authors of the First Five Year Plan placed the development of industry mainly in the hands of the private sector. . . . How did the authors of the First Five Year Plan intend to plan these "private efforts and investment"? The tasks of capital investment and of the production of private enterprises were formulated in the Plan in a general way, in the most part without expression in terms of money . . .[47]

Possibly the most interesting change in the attitude of Soviet economists toward the Indian economy is their new view of the national bourgeoisie. This class was and is considered too weak to produce an independent capitalistic Indian economy. Now, instead of viewing the weakness of the bourgeoisie as a reason for their tie to imperialism, they are viewed as a group desiring Indian independence and in light of their weakness, turning to the Indian government and its Five Year Plans for providing a solid economic base for national independence. In the government itself, these Indian capitalists play "a leading role."[48] Kupenkov explains bourgeois support of Indian State Capitalism as follows:

State capitalism in India plays a significant role. The interests of independent development of the country demand the creation of na-

[46] *Ibid.*, p. 11. For a similar view of the defects of the economy being almost totally due to foreign control, as well as a few statistics backing up this position, see: Kupenkov, A., "Industrial Development of Independent India," *Mirovaia Ekonomika i Mezhdunarodnye Otnoshenie*, Moscow, September 1957, pp. 130-135.

[47] Rubinshtein, *op. cit.*, pp. 12-14.

[48] Kupenkov, *op. cit.*, p. 130.

tive industry, especially heavy, within a short period of time. The Indian bourgeoisie are not in a position to solve this problem by their own power. They do not control sufficient financial resources for large initial capital investment. As far as foreign capital is concerned, it is interested in obstructing the solution of all these problems. Only the government is in a position to find the necessary capital to protect national industry from foreign monopoly. In its hands are the means for the mobilization of capital, such as taxes, the printing of currency, and the issuance of bonds. Also, only the government is able to use foreign capital in the interests of the country.[49]

From this change in the evaluation of the role of the native large Indian capitalists there follows a reevaluation of the Congress Party which is considered basically under their control. In the Indian election of 1957, the success of the Congress Party is explained by the fact that the voters "associated this Party with the country's success in developing the national economy and liberating the people from the heavy colonial yoke.[50]

Basically, the Soviet economists seem to approve of India's attempts to industrialize under the Second Five Year Plan. Two specific aspects of the Plan are stressed as being the most positive —the increased role of the government, and the emphasis upon development of heavy industry.

Much of the Soviet writings on the Indian economy simply attempt to prove that "For present-day India, the characteristic (of the economy) is the interference of the government into economic life." The most important branches of the economy are those in which the government is most deeply involved, especially credit control, foreign trade and heavy industry.[51] The bulk of Soviet articles are concerned solely with restating the Second Plan's proposed governmental activity for 1956-60.

Also emphasized is the Plan's proposed stepping up of the rate of growth of output of producers' goods as opposed to that of consumers' goods.[52] For the Soviet economist, the more rapid

[49] *Ibid.*, p. 132. Rubinshtein adds an additional point to this analysis by maintaining that even aside from the lack of strength of the national bourgeoisie they would not on their own create a viable national industry because they "do not expect from this sufficiently large and quick profits." p. 19.

[50] *Izvestia*, April 9, 1957, p. 4.

[51] Kupenkov, *op. cit.*, pp. 130-131.

[52] *Ekonomicheskoe Polozhenie Kapitalistichskix Stran v 1955 godu* (The Economic Position of Capitalist Countries during 1955), Vneshtorgizdat, Moscow, 1956, p. 128.

development of subdivision I of the economy (producers' goods) as opposed to subdivision II (consumers' goods) is a "law" of socialist development, while under capitalism the relationship is reversed.[53]

Unlike the sympathetic coverage of Indian attempts at industrial development, the Soviets are very critical of the "half-way" measures being taken and planned in the agricultural sector of the economy. The best to be said about the reforms taking place is that they are "limiting the position of feudalism and promoting the development of capitalist relationships in the village."[54]

Little, if any, progress was made in the agricultural sector of the economy during the First Five Year Plan. One economist, Rubinshtein, maintains that the conditions were such that

> . . . there was neither the means, nor the stimulus, nor the possibility for the improvement of methods of agricultural production . . .
>
> The mass of the peasantry was burdened by great rent payments, taxes, and indebtedness to landlords and money lenders. This situation was not changed as a result of the introduction of half-way agricultural reform in the separate states, as a rule (except in Kashmir) with full compensation to the landlords. The First Five Year Plan was not accompanied by basic changes in the agrarian situation in the village.[55]

This same author also sees little promise for agricultural development in the Second Plan.[56]

There is unanimous agreement that the Indian government's program of "community projects and national extension" is a step on the right track toward agricultural development.[57] A recent article in *Socialist Agriculture* maintained that these programs "play a positive role in the development of the village,"

[53] *Politischeskaia Ekonomiia* (Political Economy), p. 151.
[54] *Ekonomicheskoe Polozhenie Kapitalistichskikh Stran v 1955 godu*, p. 125.
[55] Rubinshtein, *op. cit.*, pp. 16-17.
[56] *Ibid.*, p. 38.
[57] See pages 235 to 245 of the *Second Five Year Plan* (Government of India Planning Commission, New Delhi, 1956) for a discussion of those programs which aim at solving the problem of "changing the outlook of 70 million families living in the countryside, arousing in them enthusiam for new knowledge and new ways of life . . ." (p. 245).

but they clearly "do not go to the root of (the problem of) agricultural reorganization."[58]

As has been mentioned, prior to 1953 the Soviet economists offered little in the way of, to use a Soviet phrase, "constructive" criticism of the economic policies existing in India. Their basic proposition was that economic progress was possible only with a radical, if not revolutionary change in the Indian government. Since 1953, this position has changed, and several Soviet proposals have been suggested for improving the rate of economic development. These proposals are few in number, but it is possible to find a general "line" and a basis for their evaluation.

When discussing Soviet economists' proposals for the industrialization of India, it should be noted that they are almost identical with the proposals of some Indian economists attached to the Congress Party. An excellent example of the similarity, as well as a point of difference, is brought out in an issue of *Pravda* on August 15, 1957. In this issue, a full page (the paper is only four pages) is devoted to the celebration of Indian independence. Here appears a major article by H. D. Malaviya, editor of the *Economic Review*, an organ of the Congress Party. The points stressed by Dr. Malaviya are generally the same stressed by Soviet economists: a general attack on the results of English imperialism, a crying need for progress, the desirability of a strong federal government uniting the country, progress made since independence, the goal of a socialist society, the desirability of the introduction of cooperative agriculture, and finally, India's desire for the friendship of all peoples. Only in the concluding section of his article do we see the difference in his approach to industrialization as compared with that of the Soviets. Malaviya sums up his article with the following:

> Not long ago I happened to be in the Lenin Museum in Gorki. There I noticed an issue of Pravda from the 4th of May 1923 containing an article by Lenin called "Better Less, but Better" (*Men'she Luchshe, da Lychshe*). In this article, significant words were said for Russia, India, China, and for future mankind.[59]

[58] Ter-Avanesian, D., "In India," *Sotsialisticheskoe Sel'skoe Khoziaistvo* (Socialist Agriculture), no. 8, 1956, Ministry of Agriculture of the U.S.S.R., Moscow, p. 93.

[59] *Pravda*, August 15, 1957, p. 3.

On referring to the article mentioned by Malaviya, we find its general theme to be,

> . . . as regards our machinery of state, we should now draw the conclusion from our past experience that it would be better to proceed more slowly. . . . We must come to our senses in time, we must be extremely skeptical of too rapid progress, of boastfulness, etc. . . . A most harmful thing here would be haste. A most harmful thing would be to rest upon the assumption that we know anything . . .[60]

The Soviet economists' approach to the industrialization of India does not refer to "Better Less, but Better." His quotes from Lenin stress the desperate need for rapid industrialization.

While favorably impressed with the concern in the Second Five Year Plan for the development of heavy industry, Soviet economists believe that it should have and could have been stressed even more. Rubinshtein devotes several pages of his study to Professor Mahalanobis's original recommendations for the Second Plan. He defends Mahalanobis against attacks that appeared in Indian publications, notably that appearing in the *Eastern Economist* of May 27, 1955,[61] concerning the question of the relative share of capital investment that should go to the development of heavy industry.[62] Rubinshtein's view of the distribution of capital investment in the Second Plan is that,

> The distribution of capital investment, although not as good when compared with the higher recommendation of Mahalanobis, with sufficient clearness points out the course of the industrialization of India in the Second Five Year Plan.[63]

Rubinshtein claims that his own proposals for financing additional investments are not original, but have been pointed out by

[60] Lenin, V. I., "Better Less, but Better," *Collected Works* (in Russian), Government Press of Political Literature, Moscow, 1951, vol. xxxiii, pp. 445-460. Aside from its general "go slow" tone, one might speculate as to the reasons why Dr. Malaviya chose this particular essay. "Better Less, but Better" was a devastating attack on Stalin and the bureaucracy he had built as Commissar of the Workers' and Peasants' Inspectorate. See: I. Deutscher's *Stalin, A Political Biography* (London, 1949), pp. 151-152.

[61] *The Eastern Economist*, May 27, 1955, New Delhi.

[62] It might here be noted that in the First Five Year Plan, 7.6 per cent of capital investment by the Indian government went into the development of industry and mining; of this, 1.3 per cent went into "cottage industry" (village and small industry). The figure for the Second Plan was 18.5 per cent, of which 4.1 per cent was to go into cottage industry. *Second Five Year Plan*, p. 51.

[63] Rubinshtein, pp. 19-27.

the "progressive Indian press." His choice of proposals is significant enough to quote him at some length:

As is obvious, the financing of the Plan is very stretched. Taxation must be increased from seven to nine or ten per cent of the country's national income; however, the Plan does not give a clear picture as to from which strata of the population it expects to receive these additional taxes. In connection with this, . . . the Plan does not count tremendous potential sources of financing . . . for example: the limiting of the export of great foreign monopoly; the reducing of the incomes of the top bourgeoisie, former princes . . . ; the reduction or the stopping of payment of compensation for land to large landlords in a period of several years . . .; the reduction of the great parasitic income of money lenders, speculators, and middlemen (*podriadchik*).

Several Indian economists consider that decisive measures on the mobilization of these potential resources could not only be sufficient to cover the expenditures of the Second Five Year Plan, but even enough to sufficiently increase the national income and capital investment that is set in the Plan. On these questions a sharp dispute is continuing in the Indian press.[64]

A final suggestion is that the government develop a comprehensive nation-wide government insurance program to tap unused sources of capital investment.[65]

Except for the last of these proposals, it does not seem possible for the present Indian government, as the Soviets interpret it, to implement these suggestions. Among the sources for additional financing are the supposed major supports of the Congress Party. The top bourgeoisie, according to Soviet analysis, are, economically, closely tied with the former large landlords. Surely a Marxist, as Rubinshtein claims to be, could not expect the class interests controlling a government to set out upon a conscious policy of self appropriation.[66]

On the question of "great foreign monopoly," another Soviet

[64] *Ibid.*, pp. 41-42.
[65] *Ibid.*, p. 42.
[66] In so far as this has to some degree taken place, plus the fact that a more equitable distribution of income is one of the explicit aims of the Indian government (see pp. 32-37 of the *Second Five Year Plan*) we may question the Soviet analysis of the economic interests that supposedly control the Congress Party. Possibly, petty bourgeoisie would more accurately describe its economic base. Or, we might even question the validity of the application of Marxist analysis to India. The latter task seems beyond the scope of this study.

economist, Kupenkov, finds that many of the problems facing the Indian economy in the period of the Second Plan could be solved by the limiting of the role of investment and aid from capitalist countries. He, like Rubinshtein, maintains that "in the Indian economy foreign capital up to this very day continues to occupy an important postion. . . . A large part of the profits received by foreign monopoly goes out of the country. This takes away from India the possibility of using them for industrial development."[67] In addition to the negative effects of private foreign investment, Kupenkov maintains that through "many kinds of so-called aid, foreign monopolies pour on to the Indian market their goods. As a result of this, many branches of native industry suffer long market crises, and enterprises work at only 50 to 60 per cent of capacity."[68] A final detrimental result of Western interference in the Indian economy is the strings that are attached to foreign loans and grants. These strings are basically attempts to keep India a capitalist country by applying conditions that limit the role of the Indian government.

One of the sharpest problems facing the Indian government today is that of massive unemployment. The problem is recognized by Rubinshtein as follows:

> In spite of several successes in economic construction, during the past few years the growth of the unemployed increased. The major source of this is the ruin of the peasantry and of light household industry which, in India, employ a significantly larger number of workers than in heavy industry . . . the growth of the unemployed hinders technical progress, and makes for an anti-mechanization frame of mind.[69]

The problem is recognized in the same way by many Western and Indian economists. The solution often offered is the increasing of investment in light and "cottage" industries where a unit of capital investment will create more jobs than the same investment could create in heavy industry. Rubinshtein completely rejects such a solution.

For the Soviet economist, the problem of unemployment will have to wait until heavy industry has been established; therefore,

[67] Kupenkov, *op. cit.*, p. 139.
[68] *Ibid.*
[69] Rubinshtein, *op. cit.*, p. 18.

It follows that the economic strategy of India must be directed mainly to the increasing of capital investment in heavy industry in order to remedy the problem of unemployment. India is not able to invest capital in the same way in heavy industry, and in those industries producing consumption goods. In the transitional period, when it will be necessary to create heavy industry, the expanding of the production of consumption goods will basically be left to household *(kustar)* industries and handicraftsmen.[70]

This difference in approach to the problem of unemployment may be due to the fact that massive unemployment is a threat to the Congress Party's continued political control. This, naturally, need not cause the Soviet economist to become overly concerned.

The Soviet economists' suggested solutions for the agricultural problems facing India are even more sparse and hazy than those concerned with industry. Only one point is made unequivocally, i.e., a much more rapid pace of land reform brought forth by the Central in place of the State governments.[71] No analysis is given as to the desirability of compensation.

The general tone of Soviet articles on the question of Indian agriculture makes the definite inference that simple land reform is only a first step. Cooperativization,[72] with its base being established in the "community projects," is viewed most favorably.[73] The necessity for cooperativization of Indian agriculture was made explicit in a recent article in *Izvestia*. The article discussed the publication of the *Report of the Indian Delegation on Agriculture to China*.[74] *Izvestia* found the Report very accurate in pointing out that cooperativization is

necessary in India for economic reasons as well as from the social

[70] *Ibid.*, p. 50.

[71] Rubinshtein, *op. cit.*, p. 38.

[72] "Cooperativization" defies an exact definition. It may mean, in its most simple form, several independent farmers pooling their labor for harvesting. On the other hand, it may refer to a situation where production takes place as on a collective farm, except that in addition to labor payments, the farmers receive some small remuneration for the land that they originally pooled to form the cooperative. The Chinese developed cooperativization into "higher" and "higher" forms until it finally blended into collectivization. For the Indians (see *Second Five Year Plan*, p. 242) and the Soviets, the "higher" stages of cooperativization are regarded as the most desirable.

[73] *Economic Position of Capitalist Countries during 1955*, p. 244.

[74] See: *Report of the Indian Delegation to China on Agricultural Planning and Techniques*, Government of India Ministry of Food and Agriculture, July-August, 1956.

point of view. Aside from an improving of the use of land and an increasing in agricultural production, cooperativization opens new possibilities for provision of the working population (with foodstuffs) and raising their standard of living. . . . In the document it was stressed that cooperativization in India must strictly adhere to the principle of voluntariness.[75]

India is viewed as a country having tremendous potention for agricultural development. In spite of her population, Soviet economists see no reason why she should in the future be a food importing country.[76] The potential of Indian agriculture is viewed as unlimited, yet Soviet proposals for the transforming of these potentials into reality are most limited.

A General Evaluation of Soviet Analysis of the Indian Economy

On first glance, it may seem presumptuous to attempt to present an evaluation of Soviet analysis of the Indian economy. One can easily see the impossibility of attempting an evaluation of, say, American economic analysis of the same subject. Yet, Soviet analysis is somewhat homogeneous, and it is so sparse that there are some general characteristics of Soviet analysis that may be commented upon. The more general problem of the applicability of Marxist economics in its general meaning will not be considered.

The first question is whether Soviet analysis is in agreement with the facts, in the narrowest meaning of the term "facts." The Soviet economist does not invent the statistics that he uses. His basic sources for statistical information are on the whole the same as those used by Western economists, the most widely used source being official publications by the Indian government. But, the Soviet economists' manipulation of these statistics is open to question. For example, on the very important and much argued question of the development of the Indian urban population,[77] Rubinshtein simply states that, in 1872, 61 per cent of the population was dependent upon agriculture, in 1921, 73 per cent,

[75] *Izvestia,* June 4, 1957, p. 4.
[76] Ter-Avanesian, *op. cit.,* p. 92.
[77] For a discussion of the complexity of the problem, see Chapter X of Gadgil's *The Industrial Evolution of Modern India.*

and in 1931, about 75 per cent.[78] No indication of the limitations or origins of these figures is given. In other instances, the Soviet economist will back up a certain line of analysis by picking official figures from those years that indicate the correctness of his position.[79]

It is almost impossible in a study of this size to support the labelling of certain parts of Soviet analysis as fallacious. Each conclusion drawn by the Soviet economist would most likely find support by one or another of his Western counterparts. But, one characteristic may be commented upon, i.e., the Soviets' creation of what we may call an "economic sterotype."

The "economic stereotype" is "imperialist" and "imperialistic economic policy." Everything associated with India's relations with capitalist countries, from the first British merchant to the Point Four Program is considered to have the same economic effect on India—absolutely negative. There is little question that when railroads were built in India the main consideration of the British government was not the future development of the economy of an independent India. But, one may question a statement analyzing the effect of railroads such as the following: "The railroads were built only from ports to sources of raw material, or had a military-strategic significance; the interests of the internal economic and cultural development of India were absolutely ignored." The Soviet economist goes on to state that the railroad was not as "progressive" from the point of view of economic development in India as it was in other countries because, unlike in India, in other areas of the world the railroads developed along with the general development of the economy.[80] One is not sure just what this means. The internal "interests" of India may have been ignored, yet, it seems valid to say that ". . . railways have been the greatest single agency for the partial industrial revolution which has taken place in India."[81] Undoubtedly, to Marx, it was in the "interests" of India to industrialize, and railways

[78] Rubinshtein, *op. cit.*, p. 9.
[79] To pick one of many examples, see *Bol'shaia Sovetskaia Entsiklopediia* on the question of the relationship between light and heavy industry, p. 48, or figures on agriculture, p. 45.
[80] Grodko, *op. cit.*, p. 262.
[81] Chaterji, Rabindranath, *Indian Economies*, (Calcutta, 1949), p. 262.

played a role in hastening this industrialization and were therefore most likely more progressive than they appeared in capitalist countries. This sort of shallow analysis seems to be basically due to the idea that anything done in the interest of "imperialists" is by necessity in conflict with the interests of India.[82]

On the question of foreign capital the Soviet economists present us with the stereotyped "imperialist." No distinction is made as to the desirability of public loans and grants as opposed to private foreign investment. They completely deny the feasibility of fulfilling the Indian desire that "we want foreign capital and technique, but do not want the foreign capitalists."[83] Any sort of capital coming from outside the Soviet bloc is viewed as an attempt to "grab" and politically "control" India.

The "imperialist stereotype" sometimes carries Soviet analysis further than simply over-emphasizing the negative effect of foreign control. In an article written by R. Gruvich in 1946, we find the following:

> Concerning the productivity of Indian agriculture, it is necessary to point out the significant withdrawal of labor power. More than 2,000,000 of the most active of the working male population went into the Army (World War II) . . . more than 1,000,000 men were brought into industry. Such a reduction of labor power in the absence of mechanization could not help but have a negative influence on Indian agriculture.[84]

The first comment to be made is that this analysis completely disregards the possibility of disguised unemployment in Indian agriculture. Many Western economists maintain that a sizable percentage of farm workers could be withdrawn from agricultural work without a decline in the production of food stuffs, the basic problem being that labor in the village cannot fully be

[82] ". . . when you once have introduced machinery into the locomotion of a country, which possesses iron and coals, you are unable to withhold it from its fabrication. You cannot maintain a net of railways over an immense country without introducing all those industrial processes necessary to meet the immediate and current wants of railway locomotion, and out of which there must grow the application of machinery to those branches of industry not immediately connected with railways. The railway system will therefore become, in India, truely the forerunner of modern industry." From "The Future Results of British Rule in India." Karl Marx, *Selected Works,* (no date), p. 661.

[83] J. K. Mitra and S. K. Chatterjee, *Indian Economics* (Calcutta, 1953), p. 143.

[84] Gurvich, *op. cit.,* p. 88.

utilized.[85] Even if the existence of disguised unemployment is denied, the changes that took place in the output of agricultural production, as distinct from distribution, may be explained by factors that appear more important and more empirically verifiable than the withdrawal of labor power.[86] In fact, by mid-1943, agricultural output (cereals) was at a higher level than it had been for the previous thirteen years.[87]

Another defect of Soviet analysis, the total disregard of the Indian population problem, may also be ascribed to the "imperialist stereotype."[88] The Soviet economists have consistently maintained that India is not over-populated, and that a reduction of the birth rate is not even a partial solution to the problems facing the Indian economy. Instead, the lacking of sufficient food for the Indian population is viewed purely as the result of past and present activities of the imperialist powers.[89] The problem of overpopulation is viewed as an invention by those "humanitarians" who complain that war, hunger and epidemics at the present time are not sufficiently lowering the population of India."[90] Only an "agrarian overpopulation" is recognized, and this situation is to be rectified with the industrialization of the country.

[85] For a convincing discussion of the existence of disguised unemployment, see: Ragnar Nurkse, *Problems of Capital Formation in Underdeveloped Countries* (Oxford, 1955), pp. 32-56.

[86] Two of these factors being, first the cyclone which swept four surplus rice producing areas in 1942—Midnapore, Parganas, Barisal, and Kinajpore. The second was the widespread disease in the aman paddy crops of Western Bengal. See Chaterji, *op. cit.*, p. 82.

[87] *The Food Statistics of India*, The Government of India Department of Food, (New Delhi, 1946).

[88] One might be tempted to ascribe this defect in analysis to Marxism rather than the "stereotype," but there seems to be nothing in Marx that would exclude considering a rapid rate of population growth as a "depressor" of economic growth. Although Marx mercilessly ridiculed Malthus's "Essay on Population," he maintained that ". . . in fact every special historic mode of production has its own special laws of population, historically valid within its limits alone. An abstract law of population exists for plants and animals only, and only in so far as man has not interfered with them." (*Capital*, New York, 1906, pp. 676, 692093.) It is difficult to see how the "Marxist heritage" forces the Soviet economist to neglect the demographic aspects of Indian economic growth.

[89] Gurvich, R., *op. cit.*, p. 86; Mel'man, *op. cit.*, p. 18; Rubinshtein, *op. cit.*, p. 16. Rubinshtein, M. "Certain Economic Questions Concerning Underdeveloped Countries," *Mirovaia Ekonomika i Mezhdunarodyne Otnoshenie* no. 3, September, 1957, Moscow, p. 67. All other references to Rubinshtein refer to his *Ekonomicheskoe Razvitie Respubliki Indii (Economic Development of the Republic of India)*.

[90] Mel'man, *op. cit.*, p. 18.

These attacks in terms of the "imperialist stereotype" which seem to lead Soviet economic analysis astray are most likely due to two factors. The first of these is an inheritance from Lenin's *Imperialism, the Highest Stage of Capitalism,* published in 1916. Here, imperialism is presented as the characteristic of dying or "moribund capitalism," and so long as capitalism continues to exist, the "contradictions of the imperialist struggle" are expected to deepen. There seems to be an unquestionable desire on the part of the Soviet economists to find, or more properly to produce, evidence to back up Lenin's predictions.[91] The second factor is the political and propagandistic aspect of Soviet analysis to be discussed presently.

Possibly the major defect of Soviet analysis of the Indian economy is the lack of internal consistency on the question of the role of the Indian national bourgeoisie. As has been pointed out, class relationships, and especially the role of the bourgeoisie play a key role in Soviet analysis. Prior to independence, the weakness of this class explained why it supported foreign rule. Then came disputes involving changes in the strength of the Indian bourgeoisie as a result of India's shift from a debtor to a creditor nation. Later, at the time of independence, the bourgeois class is viewed as supporting "nominal" independence, but still basically supporting English economic interests. Finally, the Soviet economist takes the position that the relative weakness of the bourgeoisie forces it to support Indian state capitalism.

Each of these positions could be defended if it were shown that the nature of the class was in the process of transformation. The hypothesis might be advanced that with progressing industrialization the bourgeoisie was able to free itself from its ties with feudal elements in the economy, and thereby was no longer forced to join land-owning interests in supporting the continuation of British rule. But, no such analysis is made. We are presented with no struggles or "contradictions" within the class that might correspond to the changes in the Soviet view of the group's role in the Indian economy. Because Soviet writers regard this class as an almost monolithic group, there is a total lack

[91] For the original essay as well as an attempt to provide additional evidence backing Lenin's prediction, see: *New Data for V. I. Lenin's Imperialism,* edited by E. Varga and L. Mendelsohn (New York, 1940).

of internal consistency between the pre-Stalin and post-Stalin analysis of class relationships in India.

After this short evaluation of Soviet economic analysis of the Indian economy, one cannot help but be struck with its weakness. To explain this weakness we must step into the realm of politics. In view of the radical change that took place in Soviet analysis after the death of Stalin, one is tempted to dismiss the Soviet economist as simply a "handmaiden" of power politics who rationalizes political decisions. It seems apparent that when the Soviet government began to regard a "neutralist" India as a possible ally to woo, the Soviet economist nealy took India out of the "imperialist camp," and placed the country on "her own road to socialism." Although this seems to be clearly what happened, the problem is not quite so simple.

In our earlier definition of Marxist economics, we find that "the economic development of society" is the "basis of the whole social development." If, as the writer of this paper believes, the Soviets, both politicians and economists, consider economic relations as the base upon which a society is built, then a change in the nature of a country's economy should necessitate a re-evaluation of the possible role that country might play in world politics. Within such a conceptual framework, some economic analysis is demanded, even if done by a non-economist.

In November 1955, Khrushchev stated that the desire of the Soviet Union is that "India become a great and strong government in economic terms" and that "on all sides, we are ready to help you in this good and significant task."[92] Undoubtedly, such a statement was partially based upon the premise that the measures taken by the Indian government to promote economic growth, in Rubinshtein's words, "do not strengthen, but weaken, the world capitalist system."[93] If Khrushchev felt that aid to India would strengthen "the world capitalist sytem," we could safely assume that such aid would not be forthcoming. No matter what "power politics" considerations might have been, a Marxist's attitude toward the possible role that India might play

[92] Quoted in: *Ekonomicheskoe Polozhenie Kapitalistichskikh Stran v 1955 godu (The Economic Position of Capitalist Countries during 1955,)* p. 127.
[93] Rubinshtein, *op. cit.*, p. 19.

in international affairs must include at least an implicit analysis of the nature of the Indian economy.

We can take the example of Pakistan to illustrate this point. Soviet analysis of the economy of Pakistan is at present very similar to the views held concerning India prior to 1953. Supposedly, the Pakistan economy is dominated by land-lord and imperialist interests, and therefore does not appear at present as a potential ally for the Soviet Union. There would be little reason to give substantial aid to this country when her economic progress is likely to strengthen "world capitalism." Conceivably, certain changes in the economy of Pakistan should alter these conclusions, and it would seem to be the economist's role to recognize these changes.

Therefore, it seems that for the Soviet Union the *ideal* role of the economist on questions of economic development is to provide information that would at least help in the making of political decisions. But this study has shown that economic studies follow and rationalize political decisions. If, as we maintain, economic analysis has a role to play as a guide in Soviet international relations, and if our present study is indicative of the general level of Soviet work on the economics of countries outside of the "socialist block," then we are forced to the conclusion that the international policies of the U.S.S.R. suffer from a low level of economic analysis.

SOME LONGER-TERM PROBLEMS IN AUSTRALIA'S ECONOMIC DEVELOPMENT

G. O. Gutman[1]

The Setting of the Problem

Economic development has been described as a process by which the people of a region come to exploit to a fuller extent the productive resources available to them. Where the promotion of economic development is part of national policy the object, as a rule, is to raise living standards over a period in a wide sense of the word, and a high or rising rate of investment is generally regarded as one of the requirements for achieving this objective.

A high or rising rate of investment is apt to complicate the problem of maintaining a stable internal price level with full employment without running a permanent deficit on the balance of payments; this problem is likely to be the more troublesome the greater the country's reliance on imports and the more vigorous its rate of economic development.

As Australia depends on imports for a sizable portion of her market supplies and as over recent years she has pursued her development objective with great persistency, she has suffered chronically and at times acutely from these ills. But in the Australian case the problem has had at least one unusual aspect. In formulating economic policy the raising of living standards has not been the sole objective. The twin objective has been to increase the country's population; and a comprehensive program of subsidized immigration has been operated for the purpose of attracting immigrants at target rates which over the past ten years (1948-57) have averaged roughly 1.2 per cent per

[1] This paper arose out of a discussion at the Seminar on the Problems of Economic and Political Development at the Harvard Graduate School of Public Administration and was written in the course of tenure of a visiting fellowship at the Center for International Studies, M.I.T. in 1956.

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TABLE I
Australia: Population and Employment
1948 to 1957

Year	Natural Increase	Net Migration	Population at end of year	No. of Civilian Employees excl. Wage Earners in Rural Industry and Private Domestic Employment June each year			Employees in Factories June each year	Persons Working on Rural holdings as at 31st March
				Government	Private	Total		
	'000	'000	'000	'000	'000	'000	'000	'000
1948	101	55	7,792	589	1,786	2,375	833	[a]
1949	106	150	8,046	618	1,833	2,451	866	[a]
1950	112	153	8,307	661	1,886	2,547	909	498
1951	112	111	8,528	684	1,946	2,630	949	497
1952	120	94	8,740	693	1,895	2,588	902	492
1953	122	43	8,903	680	1,881	2,561	913	504
1954	120	68	9,090	696	1,960	2,656	970	502
1955	126	97	9,313	722	2,017	2,739	1,002	499
1956	126	94	9,533	735	2,050	2,785	1,021	487
1957	135	79	9,747	743	2,047	2,789	1,024	495

[a] Not available.

Sources: Department of Immigration: Statistical Bulletins.
Commonwealth Statistician: Labour Reports; Monthly Bulletins of Employment Statistics; Primary Industries Bulletins.

annum. The rate of increase in the total population over the period has averaged about 2.5 per cent.

It is the purpose of the present paper to explore some of the problems that have arisen in this context. Before turning to them some background information may be useful.

Australia's present population (March, 1958) is roughly 9.8 million, of whom about a million are migrants who have arrived in the country in the course of the last ten years.

Gross national product in real terms seems to have grown at the annual rate of 3½-4½ per cent during recent years, and with population rising at the rate of 2½ per cent, real income per head seems to have grown by approximately 1½ per cent per annum.

Gross annual investment over the period (excluding private motor cars) has absorbed an average of 23 per cent of national product. Exports accounted for an average of 22 per cent of

TABLE II

Australia: National Income, Investment, Exports, Imports

1947-48 to 1957-58

	National Income	Gross Private Investment	Public Authority Expenditure on Public Works	Merchandise Exports	Merchandise Imports
	£m.	£m.	£m.	£m.	£m.
1947-48	1,759	370[a]	118	405	338
1948-49	1,961	380	142	541	414
1949-50	2,307	580	198	612	536
1950-51	3,130	803	288	979	741
1951-52	3,293	1,112	393	665	1,050
1952-53	3,610	517	385	848	510
1953-54	3,867	823	397	812	679
1954-55	4,127	1,047	416	758	841
1955-56	4,427	1,093	444	771	818
1956-57	4,765	978	457	973	717
1957-58	4,710	1,029	479	813[b]	790[b]

[a] Excludes movement in value of farm stocks.
[b] Preliminary.

Sources: Commonwealth of Australia: National Income and Expenditure, White Papers.
Commonwealth Statistician: Oversea Trade Bulletins. Monthly Bulletin of Oversea Trade Statistics, June 1958.

GNP, wool alone has made up one half of this, and other agricultural products (of which wheat, meat and dairy products, sugar and fruits are the most important) another third.

Since 1939 total population has grown by about 40 per cent and the work force by about 31 per cent.[2] But the increase in the working force has been unevenly distributed between the various sectors of the economy. Increases have ranged from 90 per cent in factory employment and 58 per cent in transport to a negative figure in the case of agriculture. Somewhere in between are building and construction, where the labor force has risen roughly *pari passu* with total employment and the service industries (retail, commerce, finance, professional), where rises have been a little above 50 per cent.

The decline in agricultural employment (which nowadays accounts for less than 13 per cent of total employment) during a period when the total occupied labor force has risen by almost one-half is a development of special significance in a country which has traditionally depended on agricultural products for 80 per cent of its exports.

There is among the Australian public fairly wide agreement that in the field of economic policy the maintenance of full employment should be among the government's foremost concerns; and that such a policy should at the same time make provisions for a reasonably stable level of prices, a steadily rising level of income per head and the absorption of a large number of immigrants each year.

It is also probably true that there is a general belief that these objectives can and should be achieved without any drastic increase in the degree of government interference with economic activity even though opinions differ on how far such interference should eventually be carried. There is rather less awareness among the public that these objectives are by no means naturally harmonious and that in certain situations they may be mutually inconsistent.

To explore the conditions under which these objectives can be reconciled is not the purpose of this paper, which aims rather

[2] Total employment has risen by 43 per cent because of the virtual elimination of unemployment which was heavy in 1939.

at drawing attention to some of the longer-term implications of the objectives.[8]

Before looking at specific problems it may be well to call to mind briefly the two major sources of inconsistency inherent in the desiderata listed above:

First, the level of investment required for raising productivity and providing for additional population may exceed the community's voluntary savings. In the absence of idle resources aggregate demand will then exceed aggregate supply and prices will rise. When the government acts to prevent price increases it is likely to offend against one or more of the desiderata (by reducing employment or immigration or tightening controls).

Second, at the level of spending associated with full employment the community's demand for imports may exceed its willingness or ability to export. In the absence of foreign borrowing or improvement in the terms of trade this will lead (after exhaustion of reserves) to a decline in the external value of the currency. Here again, remedial action by the government is likely to interfere with one or the other of the desiderata.

Development and the Domestic Balance

The general problems of maintaining internal equilibrium are sufficiently familiar not to require discussion here. But there are in the Australian setting some specific constraints to effective policy action which must be mentioned.

One difficulty is constitutional. The powers of the Federal Government in the economic sphere are narrowly circumscribed. They do not, for example, include (in peacetime) the power to control production, prices, rents, capital issues or internal trade. These powers are reserved to the six State governments, who can as a rule only with difficulty be rallied for concerted action on such matters. In the field of minimum wage legislation, responsibility is divided between federal and state authorities, and during recent years this has been a fruitful source of confusion.

Since 1942 the Federal Government has preempted the field of income taxation under an agreement with the States, which entitles them to federal grants out of income tax proceeds. These

[8] For a lucid general discussion, cf. H. C. Coombs, "Economic Development and Financial Stability," *Economic Record*, November, 1955.

grants, as computed under a complicated formula, have not kept up with the rise in tax revenue during the last fifteen years nor with the greatly increased fiscal needs of State governments. They are supplemented annually by gratuitous federal contributions. The increasing dependence of the States on these federal subsidies together with the Federal Government's preeminence in the loan market have enabled the Federal Government to achieve some control over the total amount of public expenditure in Australia. There is rather less coordination, however, in the direction of that expenditure. States are largely responsible for their own programs of public investment, and the absence of a common set of criteria has often presented difficulties in coordinating programs of capital expenditure and resource development.[4]

Deprived by these constitutional arrangements of many of the weapons of more direct intervention, the Federal Government has had to rely on the blunter tools of monetary and fiscal action. Here too institutional factors impose restraints. Full employment is said to have once been defined by an eminent Australian union leader as a "situation where there are always slightly more jobs than there are applicants to fill them," and the maintenance of full employment in this literal sense has become a tenet of faith with influential sections of the electorate.

In addition to the view that full employment means 100 per cent employment there is a widely held belief that it is the government's task to maintain at stable levels not only the cost of living but also the long-term rate of interest. There is no obvious explanation for this attitude. One cause may be the widespread ownership of government bonds acquired especially during the war by small savers who might otherwise have kept their funds in more liquid form. Moreover, in recent years the high level of home building activity (resulting from rapid population increase)[5] has made an increasingly large section of the population vulnerable to higher interest rates. These factors may have strengthened a tradition carried over from the days when strug-

[4] Agreement has, however, often been reached on specific issues of agricultural policy (marketing of primary products, irrigation settlements) as well as on some others (housing, shipping).

[5] There is also evidence that the average age at marriage has declined. The number of family units may thus have risen even faster than population.

gling rural settlers with heavy mortgage commitments were an influential sector of the community. The high level of public investment in "social overheads" facilities (housing, schools, hospitals, transport, power) has provided a further argument for keeping the long-term interest rate low.

There has consequently been a reluctance to impose high interest rates or maintain them when imposed. Moreover, even when imposed in conjunction with more direct measures for limiting money supply, the results have tended to be disappointing owing to widespread reliance on self-finance on the part of businesses; the absence of an adequate ancillary mechanism for directing available credit into "desirable" industries and the rapid expansion of hire-purchase credit.

Australia's traditional system of wage fixation adds a further element of rigidity to the economic structure. The federal power over wages has been delegated by act of Parliament to the Arbitration Court, which fixes a basic wage, a margin for skill and the length of the basic working week. Additional tribunals in each State perform similar functions in relation to wages, of which the determination is left to the States. Wages determined in this way have for long been fixed in real terms, subject to quarterly adjustments by a cost of living index. Since 1953 these adjustments have been discontinued by the Federal court. This action has only been partially effective in insulating wage levels from the cost of living (which has tended to rise) as some State tribunals have continued quarterly adjustments; also, unions have in some cases been able to transfer from federal to state jurisdiction and in others to obtain wage increases through collective bargaining. The fixation of the basic wage and the margins for skill, which in many cases affect professional salaries, is undertaken by the courts on the basis of a number of principles (equity, minimum needs of a representative family unit, the economy's ability to pay) which have frequently been criticized for lacking clarity and consistency. Be this as it may, there can be little doubt that real wage fixation by judicial process has deprived economic policy makers of a further degree of freedom in the pursuit of their objectives.

Enough has been said in this sketchy survey to show that when inflationary pressure develops in the Australian economy the

government is severely handicapped in combatting it with direct controls and monetary measures. There remains fiscal policy, and this can and has been used in recent years to stop at least some of the chinks (constitutional and institutional) in the government's economic armour; but here too constraints apply:

> Fundamentally the public sees the budget as the means the government uses to finance its activities and of distributing the cost equitably among its citizens. Too great a variation in the content of the budget for reasons of economic policy impairs the plain man's basis of judgment of its reasonableness and its equity. Above all, the budget cannot be frequently and violently altered.[6]

We have seen that the Federal Government lacks control over wages, prices, rents and capital issues; can make only limited use of monetary policy; has little say in the disbursement of a good deal of public spending; and can affect the direction of private investment only indirectly through the budget and the tariff, and is subject to limitations even in the use of these. It is clear that in dealing with a tendency to domestic overspending, the Australian government is, therefore, in not as strong a position as might be wished. We have also seen that the economic policy objectives to the pursuit of which the government is pledged are liable to produce just such a tendency.

In examining the longer-term implications of these objectives we may neglect more familiar problems and concentrate on those specially topical in the Australian context. How does a high rate of migration (and population increase) affect the level of investment, the rate of increase in real income and economic stability?

The motivation of Australia's migration policy is not solely economic. Considerations of national security, national prestige as well as humanitarian considerations have contributed and probably predominated in its formulation. But it is perhaps true to say that immigration is widely regarded as economically beneficial in the sense of helping towards the attainment of some notional (and perhaps elastic) optimum level of population.

[6] H. C. Coombs, *op. cit.*, p. 191. For an assessment of recent Australian experience in the field of monetary policy, cf. H. C. Coombs, *Conditions of Monetary Policy in Australia*, Mills Memorial Lecture, Sydney University Press 1958.

Whether or not there is such an optimum, where it lies, and how it can best be reached over time are not questions to be taken up here. While judgment on the economic advantages (let alone non-economic ones) of immigration must therefore be held in abeyance, it is yet possible to form some approximate ideas of the benefits involved.

Estimates for marginal capital-output ratios in developed economies differ, but there seems to be some consensus of opinion that ratios between 3:1 and 4:1 are reasonably representative. Let us assume, for the purpose of this argument, that the figure of 4:1 is applicable to Australia, that the marginal ratio is the same as the average and that the proportion of the work force to the total population does not change drastically as total population rises. Then in order to maintain real income per head constant as population rises, the proportion of GNP devoted to capital formation must each year be four times the proportionate increase in population. To absorb its annual population increase of 2.5 per cent at constant real incomes, Australia must therefore invest 10 per cent of its GNP each year under these assumptions.

Gross investment as a percentage of GNP has run in recent years at a level of perhaps 24 per cent. Net investment may have accounted for, say, 16 per cent of this. This suggests that only about 40 per cent of net investment (or 6 per cent of GNP) in Australia is available each year for adding to the capital equipment of established producers and for raising productivity per man employed. This is not a high figure by international standards. In France, for example, the figure is about 10 per cent, and in some Scandinavian and Western European countries (not to mention the Soviet bloc) where very high rates of investment are often combined with moderate population increases, this figure is even higher. It has been said, "a larger population is in a sense an alternative to a better-equipped population,"[7] and one may be tempted to add that increased immigration is an alternative to increasing productivity. But this may be asserting too much. In the first instance, returns to scale may not be constant. A larger market may enable specialization to be carried further and give rise to external economies in a great variety of ways. The benefits from these are as a rule slow in maturing and must

[7] H. C. Coombs, *op. cit.*, p. 186.

carry a heavy time discount. The amount of capital per man employed is not, however, the only determinant of productivity. New and improved techniques may be available without much additional investment; their introduction may require different types rather than greater quantities of capital; and may become possible whenever capital is replaced or added to. Thus expenditures on replacement as well as on new additions of capital may raise productivity.

It is argued sometimes that Australia's high level of investment is in part a result of large-scale immigration and that if immigrants were fewer, investment would fall. If this were correct, a decline in immigration might leave the level of net investment per employed worker substantially unaffected. But the example of other countries investing as much of their national income as does Australia, even with no immigration and little natural increase to spur them on, suggests that investment activity in Australia need not necessarily decline in the absence of immigration.[8]

It is probable, nevertheless, that given immigration the rate of investment cannot be reduced substantially without depressing real income per head below current levels. The estimates above indicate that to maintain this level might require a minimum rate of net investment of not much less than 18 per cent.

It would seem in the light of these considerations, that our earlier suspicion that large-scale immigration may have an adverse effect on productivity is not without some foundation. But one more factor remains to be considered: immigrants are an economic asset. Let us for the purpose of this exposition take an arid economic view of population looking upon it merely as an actual or potential factor of production. We see then, that in order to replace its economically active population (as it is depleted by deaths and retirement) each community must make elaborate provision to rear and train a stream of annual replacements. The proportion of a population which must, at any point

[8] For this point see also E. Lundberg and M. Hill in "Australia's Long-Term Balance of Payments Problem," *Economic Record,* May, 1956. Immigration is only one of several factors determining the level of investment. It is arguable, however, that an immigration policy by conditioning longer-term expectations affects investment indirectly (as well as directly) through its effect on these other parameters.

of time, be in this class in order for the working population to remain constant will depend on a number of demographic parameters (average life expectation, age of retirement, length of working life, age distribution, etc.). In Western countries this proportion appears to be of the order of 15 to 25 per cent. In order to expand the working population at an annual rate of 1 per cent, an additional 5 to 15 per cent of the total population will have to be included at any time in this unproductive group. If we may assume further that the proportion of national income devoted to this group is proportional to their numbers, it appears that in order to expand the working population at the rate of 1 per cent per annum, an annual expenditure of 5 to 15 per cent of national income is needed. To the extent, therefore, that the age distribution of immigrants is similar to that of a reasonably typical resident population, immigration at the rate of 1 per cent per annum will make an addition to the assets of the country of 5 to 15 yer cent of the national income. As a proportion of the total value of human resources the annual addition due to immigration would, of course, be no more than 1 per cent, and by the same process of reasoning the total value (in the sense of cost of production) of human resources is between 5 and 15 times the value of national income.

It may be interesting to refine this analysis by comparing the economies of obtaining additional working population by migration rather than by trying to affect the various demographic parameters mentioned above; and to investigate the relation of expenditure on the unproductive sector to other components of national income at various levels of income. But these matters are outside the scope of this discussion. Enough has been said to draw attention to this factor which is frequently neglected in a discussion of economic development.[9] The argument suggests that the investment costs needed to equip immigrants is probably more than balanced by their economic value measured by the cost of procuring a population increase by other means. We must

[9] Cf., however, H. W. Singer in "Formulation and Economic Appraisal of Development Projects," Book I, United Nations, p. 82. "In the United States, industrial development was undertaken by means of immigration. . . . Roughly speaking, the capital funds which were necessary for the development of the country . . . were obtained in the United States in the form of the money spent by the country of immigration in feeding, clothing, transporting and equipping the immigrants that came to the United States."

remember, however, that we know little about the productive value of human resources in the Australian economy. What has been shown is that the additional population is a costly asset to acquire and that given the demand for it, immigration can secure it at bargain rates. The presumption that a larger population is, in itself, economically advantageous must largely rest on the thesis that increasing returns to scale are available. If there are such economies, immigration will help to reap them at an earlier date than would otherwise be possible. A further advantage of immigration deserves mention. By accelerating the growth of the labor force it enables change in the geographic and occupational distribution to be carried out with less relocation of the established population. A more mobile labor force reduces the social and economic costs of expansion.

Social and political argument for immigration may well outweigh the economic and will repay detailed study. Here we may note in passing that immigration has in the past often quickened the pace of social as well as economic change by introducing new tastes, new values, and new techniques. In Australia, population has until recently been very homogenous, and geographic factors make for isolation from the rest of the world and to some extent of different parts of the country from one another. In this situation immigration on the scale of recent years is bound to prove a potent catalyst. If for social and economic reasons, immigration is desired, it must, of course, be promoted while a potential supply of immigrants is available. This has been the position in recent years but may not be assured in the longer-run.

We may sum up briefly this discussion of some of the problems of internal stability in Australian economy: (1) Policy objectives are not naturally harmonious and will sometimes be inconsistent. Their over-all bias is towards high spending. (2) Policy makers have at their disposal only a limited range of measures with which to secure the stability of the economy. (3) The immigration program preempts each year substantial resources which might otherwise be applied to raising productivity. There is no certainty, however, that the pressure on resources would slacken in the absence of immigration; and in the longer-run it adds more to national assets than its cost. Immigration is the cheapest and quickest way of realizing increasing returns to scale.

Development and the Balance of Trade

Demand which cannot be satisfied from domestic sources (because they are already fully extended) goes to swell imports. In an inflationary situation, therefore, the marginal propensity to import is likely to approach unity. Domestic overspending leads to overspending on foreign account. To the extent that Australia's balance of payments difficulties are of this nature, solutions lie within the field reviewed in the previous section. But balance of payments difficulties may arise in the absence of inflationary pressures and it is with this problem that we must here deal. Even at or below full employment levels, Australian consumers may wish to spend on imports more than foreigners are willing to pay for Australian exports.[10] Measures will then be needed to reduce the level of imports or increase exports or foreign borrowing.

In taking such measures the Federal Government faces fewer constitutional handicaps than in dealing with internal problems. It can enter into trade treaties, control imports and has certain powers over exports. Before considering more closely the various policy measures that may be feasible, we must take a closer look at the nature of the problems to which they are to be applied.

Is it possible, first of all, to arrive at some generalizations about the likely longer-term trends in the factors determining Australian import demand and foreign demand for her exports? We shall confine this discussion to the world of stable currencies and steady growth. When these conditions are absent, none of the problems that we are about to consider will disappear. Some are likely to be aggravated and this will affect the order of magnitude but not the nature of the difficulties.

Import demand will rise as the total number of consumers and their real incomes per head increase, assuming, to begin with, constant tastes and income distribution and the absence of increasing returns. What is not certain is whether it will rise proportionately or more or less than proportionately.

If population increases by 1 per cent, income per head remaining constant, then given our assumptions, import demand will also rise by 1 per cent. But when immigrants account for much

[10] In other words, left to itself, foreign equilibrium can only be achieved at less than full employment levels.

TABLE III
Australia: Value of Imports by Sources
1952-53 to 1957-58

Source	1952-53 £m.	1953-54 £m.	1954-55 £m.	1955-56 £m.	1956-57 £m.	1957-58[b] £m.
United Kingdom	214.7	331.7	378.7	355.9	296.3	325.2
Canada	19.5	18.7	23.8	23.3	22.2	23.0
India	14.6	18.5	26.1	23.5	24.5	23.4
Other Commonwealth	60.4	76.6	97.4	76.3	80.0	81.6
Total Commonwealth	309.2	445.5	526.0	479.0	423.0	453.2
Arabian States[a]	23.3	27.9	27.9	28.6	23.5	29.6
Germany, Federal Republic of	13.6	21.4	30.8	35.0	31.1	41.7
Indonesia	21.5	22.0	22.5	22.4	26.4	27.9
Iran	0.3		5.9	22.8	17.8	18.6
Japan	4.7	6.5	18.4	22.6	12.9	23.8
U.S.A.	85.2	73.3	102.2	98.8	95.5	104.7
Other Foreign	56.3	85.0	110.0	111.9	88.8	92.8
Total Foreign	204.9	236.1	317.7	342.1	296.0	339.1
Total, All Countries	514.1	681.6	843.7	821.1	719.0	792.3

[a] Bahrein Is., Kuwait, Saudi Arabia, Yemen and Other (including Muscat and Oman).
[b] Preliminary.

Source: Commonwealth Statistician: Oversea Trade Bulletins and Monthly Bulletin of Oversea Trade Statistics, June 1958.
N.B. During the whole of the above period the value of imports has been subject to import licensing.

of the population increase, tastes may not remain constant. Immigrants' tastes may run more towards foreign goods than to the tastes of natives, and to that extent the marginal propensity to import will be raised; on the other hand, immigrants are often said to be thrifty (to have a low marginal propensity to consume) and this might help to reduce overspending and the marginal propensity to import. More important, immigrants often make remittances abroad which will exert additional pressures on the balance of payments. Altogether, we may not go far wrong in assuming that population increase (with constant incomes per head) will raise import demand roughly proportionately.

It is a familiar proposition that in a wealthy country like Australia, as incomes per head rise, less tends to be spent proportionally on the production of primary industries and more on that of manufacturing industries and on services. In Australia the import content of primary products and of service industries is probably lower than that of manufactured goods.[11] With the increasing importance of manufacturing industries tending to raise the marginal propensity to import and service expenditure (on the whole) tending to lower it, no clear conclusion suggests itself. In recent years a high level of spending on consumer durables has, however, been encouraged by the extension of hire-purchase finance while service expenditure has not had a similar stimulant. A guess may, therefore, be hazarded that there may on the whole have been a tendency towards a higher (marginal) propensity to import.

It does not follow that because the income elasticity of demand for goods with relatively high import content is high, imports will rise faster than incomes.[12] Some of these goods may be produced domestically. Import substitution becomes profit-

[11] This is less certain in the case of expenditure on services which include some (entertainment and foreign travel) with high import content.

[12] Income elasticities of demand must not be regarded as constant except in the relatively short run. They will vary with changes in tastes and in the level and distribution of incomes. Changes in tastes are unpredictable; and in recent decades they have less often been spontaneous than "induced" by the advent of new or greatly improved products which have led to a continuous reallocation of consumers' expenditure. Spending patterns (income elasticities) of individual consumers are not independent of their total incomes. It follows that a given rise in national income will affect expenditures differently according to the way in which it is distributed; and even with income distribution unchanged, a rise in national income may modify income elasticities in the aggregate.

TABLE IV

Australia: Exports of Major Commodities, 1952-53 to 1957-58

Commodity	1952-53 £m.	1952-53 % of total exports	1953-54 £m.	1953-54 % of total exports	1954-55 £m.	1954-55 % of total exports	1955-56 £m.	1955-56 % of total exports	1956-57 £m.	1956-57 % of total exports	1957-58 £m.	1957-58 % of[c] total exports
Wool	419.7	49.5	426.9	52.6	368.7	48.6	352.8	45.8	503.1	51.7	394.0	48.5
Wheat (incl. flour)	89.4	10.5	60.6	7.5	65.5	8.6	66.2	8.6	81.7	8.4	42.6	5.2
Dairy Prods.	38.8	4.6	32.0	3.9	38.4	5.1	42.0	5.4	40.5	4.2	26.8	3.3
Sugar	21.6	2.5	31.6	3.9	31.2	4.1	24.7	3.2	28.8	3.0	35.0	4.3
Meat[a]	56.0	6.6	50.2	6.2	55.4	7.3	52.0	6.7	43.1	4.4	45.4	5.6
Metals and metal manufacture[b]	50.6	6.0	53.6	6.6	44.4	5.9	50.3	6.5	82.5	8.5	66.2	8.1
All other	172.4	20.3	157.0	19.3	154.4	20.4	182.8	23.8	193.7	19.8	203.2	25.0
Merchandise exports	848.5	100.0	811.9	100.0	758.0	100.0	770.8	100.0	973.4	100.0	813.2	100.0

[a] Includes canned meat.
[b] Except electrical appliances and machinery.
[c] Preliminary.

Source: Commonwealth Statistician: Oversea Trade Bulletins and Monthly Bulletin of Oversea Trade Statistics, June, 1958.

able because import prices have risen relatively to domestic, or because the domestic market has expanded giving rise to external economies; or as a result of technological innovation or increased tariff protection.

Tariffs may encourage the establishment of industries subject to increasing returns or be productive of external economies and thereby raise income per head; or they may merely redistribute income in favor of new industries and at the expense of the established ones.

Against the prospects of import replacement must be weighed the contingency that as income and population rise, a country may become more dependent rather than less on imports in some lines of production. Some industries may face steeply diminishing returns at least in the shorter-run. In Australia, occasional heavy imports of steel and coal have been in this category. But these have been evidence of temporary bottlenecks rather than incipient exhaustion of national resources, and are unlikely to be important in the longer-term.

It is sometimes suggested that in Australia import demand might be reduced by having less imagination. This is not certain, however, and the contrary may well be true. The rate at which income per head rises depends largely on the level of investment per worker employed; and we have already seen that investment might not be reduced much if population increase were less rapid. If, therefore, we assume that the rate of investment is independent of population growth, it follows that income per head will rise the less the higher is the rate of immigration; and provided that import demand tends to rise faster than income per head (as seems to have been the case in Australia in recent years) the annual rate of increase in import demand will also be the lower the higher the level of immigration.[13] With a given rate of growth of national income, population increase tends to pull the marginal propensity to import in the direction of unity unless increasing returns can be obtained quickly and unless the consumption habits of the newcomers differ drastically from those of the resident population.[14]

[13] Immigration is, however, an important determinant of the form that investment will take. To the extent that it makes for high expenditure on housing and "social overheads" it will tend to lower the propensity to import.

[14] For an estimate of Australia's future import requirements based on the

We may conclude, therefore, that (1) Australia's import demand is likely to rise roughly in line with national income as long as large-scale immigration continues, and (2) in the absence of immigration, import demand may rise faster rather than more slowly.

We have next to consider the longer-term factors governing the size of Australia's export income. A number of problems are involved. How elastic is the supply of Australian export products? And what is the nature of the domestic demand for these products? And on the demand side: what is the long-term trend in the demand for the products which Australia can export? And what is the trend in supplies from competing producers and of substitute products?

These are questions about which generalizations are not easily come by. They call for a patient and detailed examination of the demand and supply position in each commodity and each market. No more will be attempted here than to sketch very broadly some of the background against which such an examination would have to be carried out.

As we have seen the rural industries have traditionally contributed rather more than four-fifths of the value of Australia's total exports. Because of this the tendency of the early post-war years of agricultural output to lag behind the natural growth of population became one of the major economic policy issues in Australia during the late 1940's and early 1950's.

This slow growth of the primary industries was to some extent the result of government policy formulated in the light of pre-war experience. There had been a widely held expectation that agricultural surpluses would soon become a problem in the post-war period and that stability rather than expansion should be the aim of the agricultural policy. Severe shortages of essential materials and capital equipment had moreover curtailed agricultural investment and led to disinvestment during the war and the early post-war period.

Meanwhile the rapid rise in population, partly due to the immigration program, brought home the need for a faster growth

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assumption of a marginal propensity to import of zero, cf. E. A. Saxon, "Future Requirements from Rural Industries," *Quarterly Review of Agricultural Economics*, April, 1958.

of agricultural production and export income. The failure of the post-war slump to materialise and the rising trend in the prices of primary products were at the same time strengthening confidence in the long-term outlook for food products and raw materials. This change in outlook found an expression in a five-year program for agricultural expansion which was adopted early in 1952. Targets were set calling for a 20 per cent increase in production and agricultural investment was encouraged through a wide variety of measures.

TABLE V

Australia: Quantum Index of Farm Production

(Base: Average 1936-37 to 1938-39 = 100)

1947-48	1948-49	1949-50	1950-51	1951-52	1952-53
109	109	115	109	103	121

1953-54	1954-55	1955-56	1956-57	1957-58
122	123	131	130[a]	119[a]

[a] Estimated by B.A.E.

Source: Commonwealth Statistician: Primary Industries, Part I—Rural Industries.

At the same time as these policies became effective the supply position of essential materials and capital equipment for the rural industries was improving rapidly as domestic and overseas supplies were expanding and government action ensured priorities to the agricultural sector. Moreover, the improvement in agricultural prices and incomes provided to primary producers both the incentive for increasing production and the means to finance the investment needed to promote it. Rising investment coincided with (and assisted) a vast forward move in agricultural technology (it has been referred to as an agricultural revolution) in the course of the 1950's. The widespread use of more and greatly improved machinery; the widespread adoption of improved cultural and rotational practices and of pasture improvement aided by the introduction of new and improved strains of legumes; new methods of chemical and biological pest control; new treatments for diseases in stock and for minor element deficiencies in soils; these, to mention just a few, have made

possible an expansion in agricultural production on a scale which could scarcely have been anticipated ten years ago.

Moreover, it is now accepted that the potential for further development is still large and will permit in the longer term an over-all rate of expansion of the order achieved in recent years.

In short it would appear that physical and technical factors are favorable to an expansion in the supply of agricultural output at constant returns and at a rate which should be sufficient to provide both for the needs of population growth and for a volume of agricultural output increasing at a rate no less than the likely increase in the demand for imports. The brake which may check this expansion is less likely to be the "niggardliness of nature" than the uncertainty of the economic outlook.

One of the distinctive features of agricultural supply schedules is their low short-term elasticity. As a rule it takes at least a season for output to be raised; and where output changes demand an increase in capacity (land to be cleared, livestock breeding herds to be increased, water supply expanded through irrigation) the time involved may be much longer. As agricultural capacity is often specialized, investment requires reasonably assured long-term prospects and expectations of these can easily be upset by excessive short-term fluctuations. Moreover, even where confidence in the longer-term prospect is maintained in the face of short-term fluctuations, declines in farm income will limit the funds available for carrying out investment plans; and unless these funds can be supplemented by recourse to additional credit, investment will decline. In Australia bank liquidity and the availability of credit tend to decline steeply when farm incomes fall and credit for farmers is often tightest at the time when it is needed most. There is a clear need therefore for a specialized credit mechanism more closely adapted to requirements of rural production.

Institutions can (and may have to) be modified in order to remove obstacles in the way of expanding agricultural production. Developments in foreign demand, however, are likely to pose a more intractable threat to the expansion of Australian exports. This represents a new and largely unforeseen departure; for as we have seen the re-assessment of agricultural policy and agricultural outlook which took place in the late 1940's saw in

the lagging supplies of agricultural products in Australia the main source of future balance of payment difficulties. Moreover, it was widely believed in those days that the relative prices for food and raw material were likely to rise and to be maintained at levels well above those current before the war. It is only in very recent years (the mid-1950's) that the course of economic events, especially in the main manufacturing countries of Western Europe and North America have to some extent led to a reversal of this optimistic assessment. Some of the factors influencing foreign demand for Australian exports in the longer run may now be briefly reviewed.

Remembering that Australia's exports are someone else's imports, we may provisionally follow our previous line of argument and say that foreign demand depends on the rates of growth of population and income per head and on the income elasticity of demand for Australia's exports. Looking at the world as a whole, we can see further that population grows less fast than in Australia. With somewhat less assurance we may also say that incomes in the world as a whole rise no faster than in Australia. In regard to the income elasticity of demand for the commodities which make up the bulk of Australia's exports (food and fiber) it is customary to assume it to be low for much the same reason as we have assumed Australia's income elasticity of demand for manufactured goods to be high.[15] With population and income per head growing more slowly in importing countries than in Australia, the conclusion at once suggests itself that there must be a chronic tendency for Australia's import demand to exceed her export earnings.

This does not necessarily follow; for what matters is not only the foreigner's income elasticity of demand but also the proportion of that demand likely to be supplied by Australia. World demand and supply of most of the products that Australia exports is a large total of which export supplies form only a small part; and Australian exports in turn are (except in the case of

[15] It must be borne in mind that in each case both the rate of population growth and of income growth enter into the equation and that they may move in opposite directions. It is quite possible for the demand for Australia's exports to increase in countries where income per head is stagnant or declining if population growth is fast and the relevant income elasticities of demand are low.

wool and some minor items) only a small part of the world export supply. The annual increase in exports required in order to balance external accounts is again only a fraction of the total of Australian exports. Australian exports are thus a fraction of a fraction, a quantity of the second order of smalls. Such a quantity may be highly unstable in relation to the total. Take a hypothetical commodity, and assume that 10 per cent of world demand for it is met by imports and that of these, Australia supplies 10 per cent. If world demand rises by 1 per cent, the additional requirement may be met in various ways. One way would be for each country to try and supply its additional demand from domestic sources. In this case, export demand and Australian exports would remain unaffected. Alternatively, all producing countries may expand production by 1 per cent and world trade and Australian exports might rise in the same proportion. Or again, exporting countries may be called upon to supply all of the additional demand and in that case world trade in wheat would rise by 10 per cent. Finally, other exporters being unable to expand production, Australia may be called upon to supply the whole of the increase in world demand and in this case her exports would double.

What share of the increased demand will be supplied from the various sources will depend on a number of factors. One is the supply curve of the various producers which determines the cost at which additional production can be secured by each; a more important one in many cases is the extent to which governments in various producing countries are prepared to subsidize production.

If, for example, governments in importing countries decided against increasing their dependence on imported foodstuffs and raw materials, and exporting countries decided to subsidize their exports to whatever extent is required in order to maintain their share of the world market, then Australia could not expect to supply more than a constant share of world demand, and exports as determined by the three factors mentioned would in all probability fall behind the rate of growth of her demand for imports.

This may be a pessimistic view, but not one that can easily be dismissed. An attempt to appraise the problem adequately would require a detailed consideration of the pattern of world trade in

the commodities Australia exports and of the supply conditions of individual industries in various producing countries. This is not the task of the present paper.[16] But it may help to round off the picture to point briefly to some of the relevant considerations.

There is no doubt that in many areas of the world primary production can be raised only subject to steeply diminishing returns while currently used methods are applied. But in many areas these techniques could be greatly improved often at relatively low cost by adopting superior methods long practised elsewhere. The untapped reservoir of such techniques is large and constantly replenished by technological progress.

To some extent this state of affairs places the more backward agricultural economies at an advantage *vis-à-vis* the more advanced. It is the backward who, in many cases, can hope to gain most from the applications of cheap (i.e., capital saving) inventions. And there is some evidence that productivity has risen faster in recent years in the European peasant agricultures than in the more highly developed rural industries of say Australia or Canada. This development may enable these countries to maintain an increasing share of their domestic market in some products even in the face of cuts in the rate of subsidy or tariff. And in time some of these developments will spread to the agricultural economies of the under-developed world. But for the present and (if one may hazard a guess) for a long time to come Australian producers are likely to retain the edge of productive efficiency over producers in Western Europe at least in the principal staple products of wool, cereal and meat. The threat to the exporter will not come from any momentous advance in productivity abroad but from policies of agricultural protectionism in manufacturing countries and from the competition of subsidised exports.

In recent years subsidized exports have dominated the market for a number of commodities. And it appears that such pro-

[16] One salient point to bear in mind is that quantities of different orders of magnitude must be involved in any estimate. To make long-term forecasts of world demand for agricultural commodities is in itself a hazardous task. But even assuming it could be done within a narrow margin of error, this margin would involve a huge aggregate relative to the small amounts by which Australia must raise annual exports in order to achieve external balance.

grams, originally conceived as a short-term expedient, are tending to become a mainstay of long-term agricultural and economic policy at least in the United States. No matter whether such transactions take the form of sales at subsidized prices; sales against payment in inconvertible currencies or donations to assist in the economic development or short-term balance of payment difficulties in the receiving countries they exert a depressing effect on the market for commercial exports. Australia's trade in grains and dairy products has been increasingly affected by the impact of this form of competition.

Agricultural protectionism is often deeply imbedded in the social and political structure of food deficit countries; and there appears to have been an intensification of such policies in recent years. An examination of potential import requirements in Western Europe for example shows that while food requirements are likely to rise substantially in the next few years food imports may expand not at all. Much will depend on the policies adopted by the countries forming the European Common Market (and the projected Free Trade Area). What is known of the Common Market proposals clearly indicates the danger of a new and rigid preferential system being created at least as far as trade in agricultural products is concerned. Such a development would be a severe blow to Australian trade and commercial policy which in recent years has pursued with vigor the aim of disentangling Australia's foreign economic relations from the rigid pattern into which historical forces have molded it.

The British preferential tariff system and the sterling area mechanism have in the past been corner-stones of Australia's foreign trade relations. Well over half of Australia's commodity trade has been done within the sterling area and Britain alone has bought roughly one-third of Australia's exports and supplied more than 40 per cent of her commodity imports (and a much larger proportion of invisibles). In the post-war era the United Kingdom has maintained and even expanded her share of the Australian market where they have been favored by discrimination against dollar imports and by preferential *ad valorem* tariffs. There has been no similar expansion in Australian exports to the United Kingdom largely because of the operation of the three factors discussed earlier: Britain's population has

TABLE VI
Australia: Value of Exports by Destinations
1952-53 to 1957-58
£ million

Destination	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58*
United Kingdom	359.3	300.8	285.5	257.4	277.6	220.6
Hong Kong	4.9	7.8	17.3	14.1	23.4	12.6
India	17.1	14.3	19.4	12.2	28.6	11.7
New Zealand	28.7	33.5	37.8	40.9	51.0	56.1
Other Commonwealth	88.5	82.4	78.1	80.3	92.2	97.0
Total Commonwealth	498.5	438.8	438.1	404.9	472.8	398.0
Belgium-Luxemburg	32.1	32.7	31.3	26.2	35.2	28.3
France	76.0	74.4	64.1	67.3	92.0	69.9
Germany, Federal Republic of	22.4	27.1	31.8	36.4	46.9	33.0
Italy	44.7	51.3	35.9	34.6	53.0	46.4
Japan	84.0	55.7	58.6	86.5	139.0	103.0
U.S.A.	57.8	55.5	52.4	55.0	66.1	45.5
Other Foreign	55.8	92.8	62.0	71.0	88.3	96.7
Total Foreign	372.8	389.5	336.1	377.0	520.5	422.8
Total, All Countries	871.3	828.3	774.2	781.9	993.3	820.8

* Preliminary.

Source: Commonwealth Statistician: Oversea Trade Bulletins and Monthly Bulletin of Oversea Trade Statistics, June, 1958.

been stationary and her consumers have tended to spend increases in income on things other than those Australia exports; and British agriculture, greatly expanded in war-time and heavily subsidized, now supplies a larger share of the static domestic market. Moreover, Britain has discriminated less rigorously against dollar imports (especially of food and raw material) and preferential tariffs enjoyed by Australia which have been mainly specific have lost a good deal of their original value.

A survey of trends in world trade during the 1950's suggests that a good deal has been done to move obstacles and expand the flow of trade largely under the auspices of the General Agreement on Trade and Tariffs; but this expansion has largely been confined to trade in manufactured products. Agricultural commodities have benefited far less. Agricultural protectionism has tended to restrict international trade in these products and subsidizes exports, local currency deals, imported quota schemes and

the like have tended to fragment the remainder of the market and to reduce drastically the area in which price competition remains effective. Because of this it seems questionable whether much progress can be made in a discussion of this subject by means of an analysis which assumes competitive conditions and stable elasticities of demand.[17] Moreover, the evidence is strong in the world trade for many primary commodities demand and supply functions are not independent and that little can be achieved with an analysis which assumes that they are. A temporary shortage of imported supplies leads to measures to raise production of (domestic) substitutes and such measures are not easily reversed once import supplies become again more ample.[18] Vested interests are created. The national security argument may be brought into play and combined with institutional inertia to mitigate against the return to the *status quo ante*.

Short-term fluctuations in import supplies thus lead to long-term changes in import demand. This lack of symmetry in demand which appears inelastic in one direction and not in another suggests that for this type of discussion the concept of demand elasticities is of limited use. It is preferable to look at such situations in terms of permanent lateral shifts in demand schedules. These factors do not suggest an optimistic view of the long-term prospects for the growth in Australian trade even though the margin of error within which any estimate can be made must necessarily be wide.

Nevertheless, the tendency which we have noted towards increasing self-sufficiency in the supply of food is in itself likely to add to the instability in world commodity trade; as exports supply a declining proportion of total requirements of food,

[17] Cf. T. Balogh and P. P. Streeten, "The Inappropriateness of Simple Elasticity Concepts," *Quarterly Review of Banca Nazionale del Lavoro*, October-December 1950, and P. P. Streeten, "Elasticity Optimism and Pessimism in International Trade," *Economica Internazionale*, February, 1954.

[18] Australia's largest export commodity, wool, is an example: if wool prices go up it will pay to look for ways of economizing its use (re-use, reduced waste) and develop new substitutes. When wool prices drop back, there will be no comparable incentive to increase waste; new capacity for producing synthetic substitutes will not be scrapped and if its fixed costs are high and yield increasing returns to scale, it will present an increasing competitive threat. Similar arguments can be applied for other commodities for which short-term demand is inelastic. On the other hand, it is worth remembering that the existence of substitutes for a commodity will, as a rule, tend to raise its price elasticity of demand.

quite small fluctuations in domestic demand or supply in major producing countries will lead to very sizeable fluctuations in the demand for imports or the supply of exports. This must inevitably result in increasing instability of prices in the short run, and increasing difficulties in making correct predictions about the market outlook in the longer term. Agricultural production for the export market is bound to become in consequence a riskier proposition and—other things being equal—a less profitable one.

We have found that there are some grounds for the apprehension that in the longer-term Australia's import demand may be growing faster than her foreign earnings, and we may now briefly review some of the ways in which the two can be brought into balance.

The first line of defense when a deficit appears on current account is, of course, the gold reserve or in Australia's case, her London balances. But to throw the reserves into the gap opened by longer-term unbalance may buy time for finding a solution but cannot, in itself, provide one. Let us rule out the question of internal instability (which is irrelevant to the problem under review) and assume that full employment is maintained. External balance must then be established by either containing the demand for imports, increasing exports or foreign borrowings. The classical method of dealing with this problem is, of course, through variations in the rate of exchange. In Australia, however (as in Britain), there has been in recent years (at least since 1949) a growing reluctance to resort to devaluation as a means of righting the balance of payment. The practical and theoretical considerations responsible for this reluctance cannot here be discussed. But the question may be worth raising to what extent devaluation could be expected to overcome the longer-term tendency (which we have diagnosed) for import demand to grow faster than export income. A regime of periodic devaluations may be required in such a situation; if so the expectations set up by this would be bound to have far-reaching effects.[19]

Leaving devaluation aside import restrictions and tariffs are

[19] The problem of structural disequilibrium in the balance of payment and the adequacy of exchange rate variations as a method of dealing with this has recently been discussed in G.D.A. MacDougall's *The World Dollar Problem.* See especially pp. 330-35.

two methods by which the problem can be tackled from the import side. It is on import restrictions, in fact, that Australian Governments have leaned increasingly heavily in recent years in dealing with a recurrent balance of payment crisis.

Import restrictions[20] reduce the supply of imports without reducing demand.[21] The resulting excess demand may be neutralized by fiscal action but the price of scarce imports and their domestic substitutes will tend to rise and may encourage investment in new capacity and exert additional pressure on domestic resources. This argues the need for import policy to be dovetailed with an investment (as well as general fiscal) policy. It also raises the question of what should be restricted. If non-essentials and luxury goods are kept out, these industries may attract domestic capital and slow down the pace of economic development by drawing away resources from basic industries. If imports of essential raw materials and producers equipment are restricted, the result on productive efficiency and on employment may be unfavorable. A government like the Australian which lacks control over prices and investment will have to rely on budgetary measures, sales tax, depreciation allowances, etc. to nudge investment into the desired channels. But the budget may be an unwieldly instrument for such purposes and, as we have seen, the extent to which it is available for them must be limited.

If long continued, import restrictions will tend to make the trading pattern rigid and to raise import prices by assuming the status of tariff duties the proceeds of which accrue to the holders of import licenses. As a short-term measure, that is in circumstances where importers and investors do not expect them to continue beyond a limited period, import restrictions may not have much effect on trading patterns, domestic prices, or investment. To the extent that they can be anticipated they may, however, lead to speculative buying and thus become self-defeating as a short-term measure.

As economic development proceeds, import restrictions may

[20] This brief discussion of import restrictions has profited from my reading of an unpublished paper (mimeographed) by T. W. Swan on "Some Longer-Term Problems of Australia's Balance of Payments."

[21] Currency restrictions may be regarded for the purpose of this discussion as a special (and perhaps non-discriminatory) method of restricting imports.

increasingly come into conflict with a full employment policy, for there will be a tendency for raw materials and partly manufactured items to replace finished goods in the import bill; leaf tobacco may take the place of cigarettes; yarn replace cloth; motor car components replace finished vehicles. The proportion of imports than can be kept out without affecting raw material supplies and employment will in this way be steadily whittled down.

For dealing with a long-term problem we are left to rely mainly on tariffs with the option of subsidies which may be preferable where only part of the domestic demand can be supplied by the fledgling local industry. Protection provides its own problems by raising local costs and weakening the competitive position of export industries. The need for a careful study of the long-term effect of each individual case has long been recognized in Australia (as elsewhere) where recommendations on tariff changes are the function of the Tariff Board. The Board has been valuable in the past by performing the essential task of a watch-dog preventing the establishment or expansion of patently inefficient industries. But it is not clear that there has been at the Board's disposal the type of information needed to assess the value of external economies and increasing returns obtainable from a balanced expansion of domestic industries which a positive policy of tariffs and subsidies might promote. It is not certain, in fact, that the Board (or the legislature in setting it up) has ever regarded these wider aspects of development policy to come within its domain.[22] Australian tariff policy, in consequence, has tended to be piece-meal and to lack continuity. It has yet to be related to the longer-term requirements of foreign trade policy and to clearly conceived notions of the part that domestic manufacturing industry must play in the process of longer-term economic development.

Agricultural products have traditionally accounted for the bulk of Australian exports and must continue to do so for as long as one can see ahead. Nevertheless, it would be erroneous to suppose that because of their predominance they will necessarily have to bear the sole burden of providing the marginal increases

[22] These broader issues may receive greater attention from the Board in future as a result of a re-organization and expansion of its staff early in 1958.

in export income needed to maintain foreign balance. Manufactured products at present account for perhaps only 10 per cent of foreign earnings but their marginal contribution in the future could be considerably larger. Distance from consumers, the limited size of the domestic market, and Australia's exceptionally slow advance in manufacturing productivity during the inter-war period and the war years have in the past handicapped the growth of exports.[23] These handicaps may be lessened as the domestic market grows, the rise in productivity accelerates and as the progress of underdeveloped countries in the Pacific area opens up expanding markets nearer home. Foreign capital, know-how, and enterprise have flowed in on a considerable scale in recent years and combined with a higher level of domestic investment and increasing expenditure on research and technical training should help to improve the competitive strength of manufacturing industry. The advantage of manufacturing exports is that their demand is more responsive to income changes abroad than is the demand for agricultural products. Changes in the income elasticities as living standards rise are also likely to favor non-agricultural products. A foothold once secured in a foreign market for manufactured products is in this way more likely to lead to steady expansion of export income.

The aim of a positive trade policy for Australia must be to provide links between Australia's economy and those of countries where incomes and population are rising faster. The recognition of this need has recently led to a revision of the agreements governing economic relations between Australia and the United Kingdom.[24] Under the new dispensation Australia will enjoy wider discretion in lowering the levels of preferential tariffs enjoyed by British exporters. This will assist arrangements for giving other suppliers better access to the Australian market; and this in turn, by promoting the expansion of Australia's export trade, should enable Australia to ease import restrictions and to pay for increasing amounts of imports both from the United Kingdom and her competitors.

[23] For comparative data on productivity in manufacturing industry, cf. Colin Clark, *The Conditions of Economic Progress*, 2nd edition, 1951, p. 279; also A. Maizels, "Trends in Production and Labour Productivity in Australian Manufacturing Industry," *Economic Record*, August, 1957.
[24] Also more recently (1957) to a Trade Agreement with Japan.

Development and the Import of Capital

Foreign investment in the short run makes possible imports in excess of export earnings. In terms of our previous analysis that means that it allows the foreign account to be balanced at a higher level of internal spending than would otherwise be possible. We shall pass over the effects that changes in the level of capital imports may have on the various components of national income and on internal stability in the shorter run and focus attention on the bearing which capital imports have on the pace and direction of economic development. With national income kept constant any of its components may be raised in consequence of the rise in foreign reserves due to the capital imports. Investment may be raised without increasing savings, and foreign loans can thus contribute to accelerated development. To insure that foreign borrowing is in effect used in this manner, positive government action will often be needed. In Australia the Government seems on the whole to have been successful in directing these funds into the desired channels through its control of imports.[25]

The respective merits of government and private borrowing and in the field of private borrowing the merits of direct versus portfolio investment are important issues in Australia as elsewhere. The service of fixed interest foreign indebtedness will impose a steadily diminishing burden on the debtor country as its national income grows, but it may impose hardships in times when export prices decline. Foreign equity investment in the export industries may have a stabilizing effect on the balance of payment when export prices fluctuate.[26]

A domestic problem may arise where direct investment is undertaken by foreign entrepreneurs who have access to types of know-how, managerial techniques or capital equipment superior to those available to local enterpreneurs. In these circumstances its high productivity may lead to rapid expansion of the foreign

[25] Weaknesses in the machinery for co-ordinating domestic investment decisions (which we have noted above) may, however, have led to the loss of some benefits, e.g., in cases where foreign investors have been able to obtain more favorable terms by playing off competing offers received from state governments for factory sites and other facilities.

[26] This will, however, not be the case if foreign investors follow a policy of keeping dividends and other remittances constant at the expense of re-investment.

sector, especially where it enjoys tariff protection. This may enable the foreign investor to keep most of the benefit of high productivity rather than pass it on to local consumers. Where profits are domestically invested (or consumed) this will raise no balance of payment problem, but it may raise problems for local industries which have to compete with the foreign sector for a limited domestic factor supply. Factor costs may rise and, in addition, the cream of the market for scarce factors may be skimmed off into the foreign sector. The result may be a phenomenon so typical of underdeveloped countries of small islands of highly efficient foreign sectors in the midst of an economy where productivity is growing at a much lesser rate.

Measured against the beneficial influences emanating from the highly productive sector, this problem may be minor, particularly where a foreign sector can open up new export markets. The extent to which a real problem arises will depend on the size of the foreign sector, the rate at which it grows and at which its productivity outstrips that of locally controlled industry; the type of rents and quasi-rents on which its productive superiority is based; and against any social and economic dislocation must be weighed the benefits from the higher average growth rate of the economy. Problems of the sort here referred to seem to have been posed in Australia recently by the rapid growth of the local subsidiary of the American General Motors Company.[27]

Where dividends from the foreign sector are remitted abroad rather than locally consumed or invested, further complications may arise. The size of the export surplus needed to transfer these remittances will be a function of the amount of foreign capital invested, the rate at which it is increasing, the rate at which foreigners re-invest their earnings, and the rate at which new capital flows in. As long as the rate of earning is equal to or less than the rate of new investment, that is, as long as the rate of capital inflow offsets dividends and amortization payments, no export surplus will be needed.[28]

[27] See also E. T. Penrose, "Foreign Investment and the Growth of the Firm," *Economic Journal*, June, 1956; also H. W. Arndt, "Overseas Borrowing–The New Model," *Economic Record*, August, 1957, and C. Dawson, "Direct Foreign Investment," *Quarterly Review of Agricultural Economics*, April, 1957.

[28] See for a fuller discussion of these problems, Evsey Domar, "Capital Export and Balance of Payment," *American Economic Review*, December, 1950.

In Australia since 1947 foreign capital appears to have contributed something like 15 per cent to domestic fixed capital formation. Roughly a quarter of these funds were obtained through government borrowing, largely from the International Bank for Reconstruction and Development, while the rest has mainly taken the form of private equity investment. Foreign investment in the private sector appears to have accounted for about 19 per cent of the total during the period.

TABLE VII

Australia: Inflow of Foreign Capital and Income Remitted Overseas

1947-48 to 1956-57

	Direct Investment in Australian Companies			Net borrowing by Public Authorities [a]	Income derived from direct and portfolio investment remitted overseas	Public Authority Interest remitted overseas
	New Capital Inflow	Undistributed Income	Total Increase			
	£m.	£m.	£m.	£m.	£m.	£m.
1947-48	30.0	7.4	37.4	— 9	17.8	21.0
1948-49	35.8	6.1	41.9	—15	16.6	19.7
1949-50	52.2	16.1	68.3	—21	19.1	19.1
1950-51	43.7	22.4	66.1	—16	24.0	19.1
1951-52	60.7	24.2	84.9	15	25.0	19.1
1952-53	8.5	18.4	26.9	35	32.5	20.1
1953-54	34.6	31.0	65.6	— 5	40.6	21.0
1954-55	69.7	30.7	100.4	14	43.9	21.6
1955-56	73.4	39.9	113.3	36	42.8	22.3
1956-57	44.0	44.3	88.3	— 2	47.2	22.7

[a] Includes transactions with I.M.F.

Sources: Commonwealth Bureau of Census and Statistics: "Annual Bulletin of Oversea Investment 1955-56" and "The Australian Balance of Payments," various issues.
Commonwealth of Australia: National Income and Expenditure, various issues.

In Australia it appears that the rate of net earnings of United States capital in recent years has been only slightly below 20 per cent,[29] an average of two-thirds of these earnings being re-invested each year. The rate of dividend or other transfers

[29] This figure is probably not much above the normal return to U.S. foreign investment, but it is more than double the average earnings of British equity capital in Australia.

seems to have been very nearly the same as the rate of inflow of new United States capital. These capital imports have therefore made no net direct contribution to Australia's balance of payment problem.[30] United States investment in Australia has, however, grown at a rapid rate of only slightly less than 20 per cent per annum compared with a rate of expansion of the economy of 4 per cent per annum. If maintained at this level, American owned investment in Australia would double every three to four years and could result in a relatively short time in a vast extension of United States ownership in the Australian economy. With current rates of growth maintained, the proportion of fixed capital in Australia owned by United States investors (which at the present may be about 2 per cent) would rise to about 10 per cent in 1965, 45 per cent in 1975 (and 99 per cent in 1984).[31]

For many obvious reasons not a great deal of significance need be attached to this type of figuring. But it helps to remind one of the striking changes that can occur in quite a short period in the relative magnitudes of two quantities growing at different compound rates. The simplest way of avoiding these problems is by relying on fixed interest loans in preference to equity capital; and by attracting managerial skill and know-how not in the form of foreign enterpreneurship but under contract as salaried managers and technicians.

For a long time to come the possible adverse effects of foreign investment may in Australia as elsewhere be overshadowed by the difficulties of attracting foreign investment on a scale needed to finance the imports required for economic development. In the past Australia's foreign capital needs have in the main been met by the United Kingdom. Even in recent years when United States (and Canadian) capital has assumed increasing importance, Britain has still provided two-thirds of the total.

The continuance of this flow of long-term capital from the United Kingdom is, however, by no means assured. Great

[30] There may, of course, be indirect contributions through import savings and through creation of external economies enabling export industries to compete more successfully abroad.

[31] The actual amount of U.S. investment in Australia during recent years has been of the modest order of $60 millions per annum; as against this U.S. investment in Canada has been of the order of $800 millions per annum.

changes have occurred in the economic position of the United Kingdom, who since the war has become the world's biggest debtor (from being the world's biggest creditor), and has no longer been able to set aside from her domestic savings large sums for investment abroad. In spite of this the U.K. has in recent years managed to maintain, to some degree, her traditional role as a supplier of long-term capital to Australia (and other countries) by channelling to them funds which she has obtained elsewhere.

The sources of much of these funds have been dollar loans and grants (from the U.S. and Canada) and short term balances accumulated in London by other sterling area members—mainly the non-self-governing territories.[32] Neither of these sources can be looked to to the same extent in the future. Dollar aid has included many non-recurring items (the U.S. and Canadian loans) and others are of a temporary character. Short term funds kept in London are bound to decline as economic development proceeds in the various colonial territories and their capacity to absorb capital expands. They may then even become net borrowers instead of net lenders as at present; the advent of self government in Malaya and West Africa may accelerate this evolution.

A shrinking supply of long-term capital available for foreign lending within the sterling area thus meets a rising demand, and Australia may be hard put to it in attempting to cover her requirements from this source. Measured against the world supply of capital, however, Australia's demand is of a low order of smalls; and consequently changes well within the margin of error of any reasonable estimate—in the size or allocation of the total—may mean to Australia the difference between capital famine and capital surfeit.

With this in mind we must, nevertheless, conclude that capital imports may become harder to get, at least from traditional sources; and that increased reliance on U. S. and Canadian investors who are alone in a position to make up the leeway may pose new issues of social and economic policy and, quite possibly, may make little direct contribution to the solution of the balance of payment problem.

[32] For a detailed discussion of this cf. F. W. Paish, "Britain's Foreign Investments: the Post-War Record," *Lloyd's Bank Review*, July, 1956.

Conclusions

From a discussion which has roved over so wide a field as the preceding one we cannot hope to obtain a detailed map of the terrain. But perhaps it can roughly mark out the route of further advance by sinking at wide intervals a few signposts on either side of it.

A number of objectives are felt to underlie economic policy-making in Australia: full employment, rising income, rapid population growth, reasonable price stability and an injunction against drastic changes in the degree of government intervention.

Between these objectives conflicts are liable to arise, and in formulating policies to resolve these the Federal Government is hampered by certain constraints. These are partly constitutional (division of powers between Commonwealth and States) and partly institutional (real wages fixed by the judiciary, public opinion wedded to the concepts of 100 per cent full employment and a low and stable long-term rate of interest). Some easing of these constraints would facilitate adoption of prompter measures for dealing with short-term disturbances and might contribute —especially in the field of investment (both public and private) —towards the long-term objectives of development.

Immigration policy, a special feature in the Australian picture, has several aspects. In terms of its investment requirements the cost is high and may make for a slower advance in output per man than might otherwise be achieved. But the benefits are also high, for human resources are an expensive asset and—given the demand for them—immigration is a cheap way of acquiring them. Moreover, there is no certainty (and little likelihood) that the level of investment and pressure on domestic resources would decline were immigration to cease; by the same token import demand (which depends partly on income per head) might be higher rather than lower in the absence of immigration. Finally, a high rate of immigration promotes mobility of labor and may accelerate economic and social progress.

It seems likely that growth in import demand will not, in the absence of policy action, be much below the rate of growth of national income and that this rate is likely to exceed the rate at which export income is rising. Import restrictions are an unsatisfactory way of attacking this (long-term) problem. Tariff pol-

icy will have to provide much of the ammunition; to do this it may need to have its status raised from the subordinate and essentially negative role it has played in the past and to be related in a far more comprehensive way to the long-term requirements of economic growth and foreign economic policy.

On the question whether exports will expand at the same rate as import demand we reached an adverse verdict, subject to an important proviso: Australia's export supplies are a magnitude of a low order of smalls (except in the case of wool) measured against the totals of world demand and production. Minor changes in either of the latter, well within the margin of error of any estimate, may therefore have quite disproportionate effects on Australian export opportunities. Keeping this in mind we must nevertheless conclude that, given current rates of growth of world income and population, demand elasticities for Australia's major export products, and the prevailing trend in economic policies, the demand for Australia's exports may not keep pace with her demand for imports. Here, too, policy can contribute. It can vary the pattern of trade (somewhat ossified by preferential arrangements of long standing) and achieve closer links with countries who can offer expanding markets to Australian exports. New export industries (to be established if necessary with the assistance of foreign capital and know-how) can diversify trade and open markets less subject to the limitations which handicap exports of primary products. Finally, there is wide scope for maintaining and raising the efficiency of these established export industries. Yet here, if our analysis is valid, the scope is more restricted than is often thought; not only because conditions are less competitive and demand elasticities lower than the textbooks have led us to believe, but because their traditional price theory itself has only limited application to the real world, where demand is a function of supply and elasticities tend to be irreversible.

Can capital imports bridge the gap between export earning and import demand? Again, our conclusion is not wholly encouraging, subject to a proviso similar to the one tacked on to our findings on export demand: Australia's capital needs are small relative to the world supply of investment funds, and minor changes in that supply, the demand for it or the direction of its

flow, will profoundly affect the Australian outlook. Imponderables apart, however, the supply of capital from Britain, which has always been the major source, is unlikely to rise and will probably decline. American (United States and some Canadian) investment, if it keeps on rising at the rate of recent years, may take the place of British. If so, new problems may be raised, both social and economic, and with earnings and dividend rates at current levels the direct contribution of such investment to the balance of payment problem may be small. The indirect benefits may be higher (increased productivity, new techniques, know-how filtering from the "demonstration sector" into the economy at large), but many of these might be obtained more cheaply through management contracts than by means of foreign equity investment.

In summing up, we may once again remind ourselves that in the Australian context much can be expected from external economies and increasing returns; and their contribution, though not amenable to quantitative estimate, will tend to soften the conflict between policy objectives.

A survey of these has shown that immigration may be less of a cuckoo in the nest than has commonly been supposed: its impact on stability internal and external, may be minor and reducing it will help little. Full employment in Australia as elsewhere is the costly objective, at least until the institutional environment has adapted itself to it. But it is a social concept that may be worth a high price.

Finally, where much is unpredictable the limits within which estimates can be put and adjustments made are necessarily wide. And one's appraisal of each final position (if there is one) is largely subjective: the optimist declares that we live in the best of all possible worlds; the pessimist fears that this may be true.

THEORY, PLAN AND PRACTICE: ASPECTS OF ECONOMIC CHANGE IN CEYLON

R. H. Green[1]

Introduction

Economic development has regained its classical status as one of the most important and most popular fields in economics with the simultaneous advent of vastly increased interest by economists in the processes of economic change as opposed to the analysis of static or marginally variable situations and the "revolution of expectations" preceding and accompanying the securing of national independence by colonial territories throughout most of Asia, Africa and the Middle East. The government official, the political economist practicing as an advisor, the applied theorist developing special case applications, and the pure theorist seeking to explain the dynamics of national income are all hard at work in the field. Unfortunately, in no other area of economics does the gap between theory and application, case study and generalization seem as wide. To date economic development theory combines rules of thumb like those of Adam Smith, simplistic models such as David Ricardo's, and a variety of unrelated, fragmentary and contradictory concepts which fail to add up to a useful tool box for practical application. Applied theory often strikes unhappy compromises between the theoretical models and convictions of its authors and the apparent facts of the situations with which they are dealing. Actual plan implementation proceeds in total defiance of both pure and applied theory often with results successful enough to raise doubts as to the validity of many of the concepts and models which decreed their failure.

Certainly, many of these gaps are the direct result of inadequate data. For scarcely any underdeveloped countries or long-term development plans are adequate, or accurate, statistics available. However, with the growth of uniform statistical reporting and the preparation and pursuit of clearly defined economic ob-

[1] This paper is the development of work done in the International Trade Seminar during 1956-57 under Professors Seymour E. Harris and Gottfried Haberler.

jectives through identifiable policies it is becoming increasingly possible to compare economic magnitudes and changes with both theoretical predictions and plan goals. One of the countries in which this may be done to advantage is Ceylon where an exceptionally adequate statistical base facilitates study of economic policy, planning and progress since World War II.

Before attacking the substantive data certain definitions and theoretical points need to be clarified for purposes of this paper. Economic development will imply a rising per capita standard of living combined with a predictable, if not necessarily immediate, decrease in both open and disguised unemployment. Asian economic development is proceeding under conditions which render her experiences considerably less than directly comparable with those of North America or Europe. There are, on the one hand, less resources to develop. On the other, the populations are backward and have a limited desire for economic progress. Perhaps this last point is better described as a lower willingness to apply effort to attain the goal of economic development.

Professor Myint has argued that the basic problem confronting the economically deficient countries is really one of backward people, rather than underdeveloped resources.[2] Professor Frankel advances the even more drastic suggestion that goals and goods are so different as to render both Western experience and Western theory totally invalid.[3] While both of these views are refreshing correctives to the facile transplantation of plans tacitly assuming Western institutional settings to Asian and African environments, neither appears to be fully applicable either in general or in relation to Ceylon.

A backward people without resources cannot attain high standards of living. On the one hand, seeking to attain Western standards of economic achievement in Libya, given its known and probably resources, is a pipe dream. On the other hand, backward labor when combined with complementary resources can most certainly be an important agent of economic progress. Indeed it can be argued that much of the difficulty involved in

[2] Hla Myint, "An Interpretation of Economic Backwardness," *Oxford Economic Papers*, June 1954.

[3] S. Herbert Frankel, *Some Conceptual Aspects of International Economic Development of Underdeveloped Territories* (Princeton, 1952).

computing capital-output ratios over time, developing operational balanced growth models, and determining proper resource utilization lies in the fact that backward labor when combined with land and capital develops more efficient labor and eventually increases the total product, entirely apart from the addition of other resources. Education, health and technological innovation are some of the avenues through which Ceylon has sought to channel capital into the development of labor.

This view of the concept of backward resources is also applicable to land which has been used to less than capacity because of inadequate technical knowledge. It sheds some light on the vexed problem of the capital/output (c/o) ratio which has been accepted as an all explicative factor[4] and condemned to oblivion as utterly valueless.[5] Neither approach is truly tenable. "Social welfare capital" designed to "forward" labor or land does not have the same c/o as "structural investment" in roads of "direct investment" in plantations or mills. Quite possibly its over-all level is lower since in the case of technological improvement the entire amount spent on introducing a better variety of seed or technique of water control may be recovered several times over in increased income during the succeeding crop season alone. Certainly this has been the experience of Ceylon with work designed to improve rice paddy yields. The absence of "social welfare capital" could in extreme cases raise the easily observable c/o ratio to infinity because the investment was in fact rejected by the population or used with almost total inefficiency. In the more normal case, its presence may result in a substantial difference between the total achieved by averaging the "direct" and "structural" c/o's and the additional income resulting from a given development program.

The applicability of Western motives is both an empirical and a theoretical question. It seems highly doubtful that economic development has generally been initiated as a result of mass support. Certainly the evicted yeoman described by Sir Thomas More and Oliver Goldsmith, the home loomsman broken by the rise of the factory whom Karl Marx depicts, and the mod-

[4] Saiiyid Abbas, *Capital Requirements for the Development of South and Southeast Asia* (Amsterdam, 1955).
[5] Frankel, *op. cit.*

ern Turkish peasant turned from his rented holding with the advent of tractor cultivation did not seek either technical change or the economic progress which accompanied it. However, genuine economic development does seem to become popular over a period of time if it can proceed swiftly enough to be perceptible to the average man. On this historical basis the charge that a few Western trained economists and politicians have framed the development plan in Ceylon is largely irrelevant. This is especially true since Ceylon has begun to share the Indian experience in which development has become a living issue engaging the support of the masses of peasants and workers.[6]

While it may be true that economic progress holds a lower place in the Asian set of values than in the Western, this does not necessarily invalidate theoretical frameworks, input-output ratios or less sophisticated rules of thumb. While the amount of resources devoted to economic development will be regulated by the emphasis placed upon it, Professors Robbins and Lange are basically correct in maintaining that any set of motives can be used with a valid production theory obviously with different effects but without invalidating the theory.[7] In short, the extreme position which holds that Asian values preclude valid comparisons or conceptual carryover is both theoretically unsound and empirically weak.

Ceylon: Economy in Transition

Ceylon's economy, as well as her society, is in rapid transition. The general directions are fairly plain, the details vague, the fact of change obvious. Independence and nationalism, the falling death rate, an increase in egalitarian political sentiment, an annual increase in population approaching 3 per cent per annum and the decaying caste system combine with rising communal strife, overfragmented land and hopelessly inadequate title registration, the near-full exploitation of low elasticity ex-

[6] Max Milliken and W. W. Rostow, *Proposal for a New Foreign Economic Policy*, Massachusetts Institute of Technology, mimeographed copy, pp. 24-33.

[7] This sidesteps the issue of the validity of a North American-European based production theory in Asia. In fact, a different theoretical frame must be developed because institutional factors, resources and opportunities are different. Once developed, this frame can be expected to yield satisfactory analyses of data fed through it even if motivations change.

port markets for three exports which supply 40 per cent of the national income, the massive Six Year Plan—all point to continued change.

They also highlight Ceylon's basic problem, the creation of an economic system capable of providing food, clothing, shelter and public services for her population today and higher standards for a larger population tomorrow. True per capita income has tended to rise over the past twenty years but there seems to

TABLE 1

Per Capita Income 1938-1955 (at constant prices)

	1938	1947	1949	1950	1951	1952	1953	1954	1955	1956
National Income at current prices (Rs million)	596	2509	3013	3796	4521	4441	4419	4800	5195	4899
National Income at 1938 prices	596	732	978	1115	1269	1238	1218	1323	1423	1352
Estimated Midyear Population (,000)	5826	6903	7321	7554	7742	7940	8155	8385	8576	8776
Per Capita Income at 1938 Prices (Rs)	102	106	134	148	164	156	149	158	167	154

Sources: *The Six Year Programme*, p. 4.
Economic Survey of Asia and the Far East 1956-57.

be little ground for assuming an automatic continuation of the rise. Indeed, most of the capital creation statistics of the Economic Commission for Asia and the Far East when applied to commonly accepted c/o ratios would lead one to expect a drastic fall.

A serious question still exists as to whether Ceylon is entering a period of self-sustaining economic growth or merely perfecting an enclave economy resulting in "the bringing of political and economic institutions which would add new regions and other peoples into the accepted framework of reference for economic action" but in which "the very notion of 'developing' a whole community, a whole people, or an underdeveloped territory did not arise."[8] Certainly Ceylon's plantation economy has often appeared to the Ceylonese to involve little more than the seizure

[8] Frankel, *op. cit.*, p. 16.

of common lands, the importation of Indian labor, the domination of British managers and financiers, the remittance of payments for supplies and food to India and the United Kingdom, and the use of Celyon's natural resources to support foreign rentiers.[9] This resentment underlies to a large measure Ceylon's extraordinarily steep export and import duties and income taxes which are clearly designed to redistribute economic power as well as to finance development. The welfare of the country has replaced the individual gain of the investor or promoter as the yardstick of progress. In 1946 the Ceylonese Government stated

> Ours is a typical plantation economy specializing in the growing of agricultural products which are exchanged in the world's markets for food and manufactured articles. Except for the operations incidental to processing for export there were until very recently no local manufacturing industries of any significance. Our exports lack variety; three major commodities, tea, rubber and cocoanut account for more than nine-tenths of the export value.
>
> We depend on imports for the greater part of our food, all our clothing and for almost all the conveniences and amenities of civilized life. Two-thirds of our population live in the wet zone occupying one-third of the land. . . . Not only is our national income low, the best pre-war estimate placing it at under 100 rupees per head, but as with every agricultural economy geared for export it is also liable to wide fluctuations which tend to intensify the miseries of an already low standard of living. On the other hand, there are extensive national resources still untapped and relatively large areas to be peopled.[10]

While certain details could be challenged this is as accurate a summary of the economic situation in 1946 as can be made in two paragraphs. Since then notable changes have occurred. Per capita income has risen to over 150 per cent of 1938 levels, agricultural "colonization" of the underdeveloped, drier areas has begun, the conquest of malaria has improved the health of the population but increased the threat of a demographic explosion.

Compared with the average underdeveloped nation Ceylon

[9] Henry M. Oliver, *Economic Policy and Opinion in Ceylon* (Durham, 1957), pp. 12-21.

[10] *Post War Development Proposals*, Government Press (Columbo, 1946), p. v.

holds three major assets and two potential ones, but shares two staggering liabilities with the rest of South and Southeast Asia. In 1955-56, the Island's favorable trade balance approached $100 millions and though recent surpluses have been smaller her import-export status has remained strong; the government is relatively efficient and staffed by civil servants well trained in economics and devoted to national development; supplies of developable resources including arable land are reasonably ample. The decaying caste system offers the potential of greater mobility both in terms of area and occupation while the very poor agricultural methods now employed in the production of rice, rubber and cocoanuts afford a striking example of the potential "advantages of backwardness" posited by Professor Gerschenkron as an important factor in facilitating economic change. On the other hand, the runaway population is proving a severe drain on the Island's capital resources, threatens the trade balance by increasing the need for rice imports, and leads to increasing pressure on the land resulting in uneconomical subdivisions of holdings. Equally important, although probably easier to meet, are the problems entailed in adapting Ceylon's financial and land tenure system to economic progress.

In Professor Rostow's terminology, Ceylon has a low propensity to develop fundamental science, a higher but non-generalized propensity to apply scientific data to economic ends, a high propensity to seek material advance, a somewhat low, initial propensity to accept innovations, and extremely high propensities to consume and to have children.[11] He doubts that the Island has achieved the capacity for sustained growth but indicates that it has attained the status of an economy fairly rapidly developing the preconditions for such growth.[12]

The Basic Factors: Land and Demography

Ceylon's Gross National Product (GNP) reached a new high in both per capita and total terms in 1955 at levels of over 600 and nearly 5.2 billion rupees ($120 and $1.04 billions respectively). The movement of national income as shown in Table 1

[11] W. W. Rostow, *The Process of Economic Development* (New York, 1952), Ch. I.
[12] W. W. Rostow, October 1956 lecture at Harvard.

has tended to be upward with slumps in 1952-53 and 1956-57, the result of export reactions rather than internal structural problems. Even the disastrous 1957 fall floods do not appear to have had more than a short-run significance. Ceylon, then, is one of the few South Asian nations in which a sustained rise in national income and per capita income has taken place since 1945 and in which prewar levels have been substantially surpassed.

TABLE 2

Gross National Product

		1951		1952		1953	1954
Exports		1779		1381		1457	1666
Tea	800		723		825		
Rubber	582		373		338		
Cocoanut	373		259		134		
Locally Consumed		1080		1271		1249	1305
Rice	200		344		290		
Cocoanut	166		131		157		
Other Food	303		349		354		
Industrial (Including C)	159		178		188		
Trade, Domestic		386		407		331	
Transport, Domestic		180		191		192	
Professions		55		57		57	1829
Services		271		279		288	
Rent		68		76		82	
Capital Development Industries		390		409		377	
Government		363		394		411	
Income from Abroad		47		42		35	
NP		4619		4507		4479	4800

Source: *The Economic and Social Development of Ceylon*, p. 129.

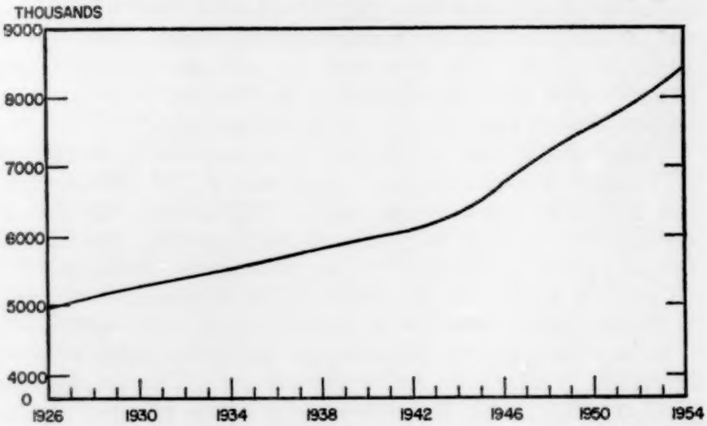
The agricultural basis of Ceylon's GNP is clearly shown by the breakdown in Table 2. Over 90 per cent of all exports and 80 per cent of locally consumed goods come from the agricultural sector. Four crops–tea, rice, cocoanuts, and rubber accounted for over 40 per cent of GNP in 1953. The 1946 Census showed

one-half of those gainfully employed as being engaged in agriculture, a proportion which is probably an understatement.

Inadequate over-all land development and an immobile rural population have caused a steady decline in land per member of the rural population from .75 acre in 1911 to .50 in 1950.[13] This effect has been hastened by the rapid population increase shown in Chart I and explained by the sharp decline in the death rate and stable birth rate shown in Chart II.

CHART I

Estimated Total Population—Midyear 1926-1954



It must not be assumed however that the reduction of death rates is necessarily unfortunate even from a purely short-term economic viewpoint. The control of malaria has resulted in a sharp increase in the normal health of Ceylonese workers as well as an increased life span. These factors should not only allay the "waste" of capital expended to raise children who fail to become members of the working force but also to increase the potential output per man. In view of the International Bank Mission's findings that Ceylonese labor tends to be less efficient than In-

[13] *Six Year Programme of Investment 1954-55/1959-60*, Government Press (Columbo, 1955), p. 159.

dian[14] and George Rosen's conclusions that, in terms of output per unit wages Indian labor is actually high cost,[15] any steps likely to improve labor productivity should be stressed.

The opening of new land is necessary both to solve the short-run population problem while long-run solutions can be achieved as well as to improve the efficiency of peasant agriculture. N. K. Sarkar has found that while the optimal family farm would probably run between 5 and 8 acres actually over 70 per cent of all farm families own less than one acre and less than 7 per cent own five or more.[16] Unfortunately, current evidence suggests that while the transfer of landless peasants to new areas is reducing the problem of the landless rural worker, continued subdivision of holdings under one acre has risen even faster intensifying the problem of disguised unemployment. Sarkar finds that in 1946, 2.8 people were dependent on each acre of land in the peasant sector while the research of the Ministry of Agriculture suggested an optimal ratio of one person per acre.[17]

Today almost half of Ceylon's estimated tillable acreage of 6.75 million is unused. Export crops occupy 2.25 million acres, rice and miscellaneous crops another 1.25 million. Of the remaining 3.25 million, 600,000 acres are potentially suitable for irrigated paddy cultivation.[18] Their reclamation would add over 50 per cent to current rice output while additional areas could be dry-farmed successfully on a one crop per year basis.

As important as increasing acreage, and less expensive in terms of capital, is increasing the output per acre. The average rice yields are appallingly low when compared to those of similar rice growing areas elsewhere in Asia. Indeed the same comment can be made of almost all crops except tea and is painfully evident in the rubber and cocoanut industries where inefficient production has threatened to price Ceylonese products out of the world market.

A major goal in Ceylon's Development Plan is the attainment

[14] International Bank, *The Economic Development of Ceylon* (Baltimore, 1953), p. 82.

[15] George Rosen, "Output Ratios in Indian Industry," *Indian Economic Journal*, October, 1956.

[16] N. K. Sarkar, "The Population Trends and Population Policy in Ceylon," *Population Studies*, March 1956, pp. 196-200.

[17] *Ibid.*

[18] Rosen, *op. cit.*, p. 35.

of rice yields of from 45 to 50 bushels per acre. Village extension work designed to reduce the prevalence of over-watering which wastes a scarce resource while actually lowering output and the introduction of better transplanting procedures have already raised the yield from 21 to 24 bushels in 1947 to over 30 bushels in 1954, an average increase of over 4 per cent per year. In terms of food imports the achievement of this target will result in a saving of 300 million rupees per annum in foreign exchange. Similar efforts to increase the efficiency of rubber and cocoanut production are called for in the Six Year Plan. These export crops, and especially rubber, are threatened with absolutely decreasing output and overpricing. In both cases, Ceylon sells on a virtually competitive market so that cost reductions will tend to benefit her economy rather than being passed on to consumers.[19]

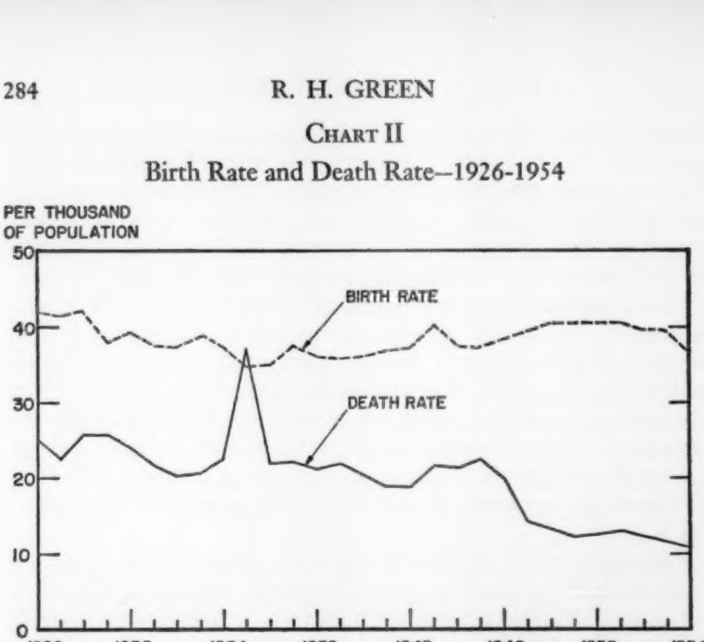
Development in Ceylon is virtually synonymous with the "colonization" of the dry area so far as the peasant population is concerned. The largest project, Gal Oya, is designed to provide a new opportunity for landless rural families on eight acre holdings (5 irrigated, 3 dry) prepared and rented by the government. The International Bank Mission found the process of colonization generally well handled although it questioned the need to provide as complete facilities as those now offered in view of the increased rural mobility resulting from the development program and leading to a surplus of applicants for resettlement. The Six Year Plan calls for the establishment of 43,000 village extension programs on the borders of presently cultivated regions.[20]

While these figures suggest that qualitative and quantitative measures may result in a doubling of Ceylon's food output over the next 10 to 15 years this will provide only passing relief from balance of trade and employment problems unless a solution to the demographic problem is achieved. A preliminary analysis of data, which are generally inadequate for the post-1947 period, yields several pieces of none too encouraging information. The first is that while death rates have been halved since 1946, gross reproduction rates have not fallen since 1922. Indeed a postwar

[19] K. Tharmatram, *Demand for Certain Exports of Ceylon*, Government Press (Columbo, 1955), Chapters IV, V.
[20] *Programme*, p. 39.

CHART II

Birth Rate and Death Rate—1926-1954



rise caused it to increase from 1.963 in the 1930's to 2.162 in the mid-1940's.[21]

While the age of marriage has increased markedly in recent years this factor has apparently been offset by the fact that life expectancy of marriage remains near 100 per cent and the increased life span means that later marriages do not necessarily result in less children. Columbo's demographic records combine the highest major city birthrate in the British Commonwealth with one of the lowest death rates (35.0 and 9.9 per 1000 in 1953).[22] Columbo's birth rate of 35.0 is appreciably below the over-all rate of 37.4 but the fact that its population is increasing proportionately less rapidly than that of the Island cancels out whatever effects might be hoped for from urbanization.

The question which underlies attempts to control population pressure and to increase per capita income: Will the farmer who grows more rice by using better methods simply eat it, subdivide his holding among his heirs, and reestablish the status quo? Sar-

[21] N. K. Sarkar, *op. cit.*, p. 195.
[22] *Demographic Study of the City of Columbo* (Columbo, 1954).

kar's studies in Ceylonese villages indicate that the answer may be "no."

> Most of the difficulties (encountered in controlling the rate of population increase) operate today because the solution has been more or less prevented by political circumstances. Once an escape from hunger, degradation, and poverty is opened to the people, there cannot be any doubt that they will flee from the agrarian cultural pattern and the bare subsistence it provides. Already the signs of such a movement are discernible.[23]

> For a society in which girls of respectable family rarely have roles outside the home, the wide support both for their education and their employment in factories is noteworthy. A common sentiment was "even girls could earn and support us."[24]

Professor Ellsworth cites a parallel case in Malajaya, West Java in which the introduction of inexpensive but efficient handlooms led in the ten years from 1931 to 1941 to a doubling of literacy, more sustained work, later marriage, and planned family size as among those in the participating villages in comparison with nearby groups not employing the improved techniques. A definite correlation between technical change, higher incomes and rational economic behavior was observed according to Dr. Hubertus van Mook, former Governor General of the (then) Netherlands East Indies. The same villages showed considerable ingenuity in the division of labor on a small scale, e.g., in the manufacture of umbrellas and cigarette lighters.[25]

Sarkar contends further that, in the past, high birth rates have been conditioned by the mental attitudes associated with a society in which many children were vital to the preservation of the family and that these attitudes will change now that the death rate has fallen. His contention would appear to be at least partially borne out by European experience. If one accepts the examples and contentions of Ellsworth and Sarkar and combines them with the findings of low labor efficiency as the result of debilitating illness a strong case is produced for continued high

[23] Sarkar, *op. cit.*, p. 207.
[24] Bruce Ryan, "The Ceylonese Village and the New Value System," *Rural Sociology*, March 1952, p. 24.
[25] Paul T. Ellsworth, *The International Economy: Its Structure and Operation* (New York, 1950), pp. 383-84.

expenditures on public health. Such expenditures would on these assumptions lead to greater productivity per man and eventually to lower birth rates as well. They call for low-mortality rates and rising per capita income to lead to a stable population and imply the futility of seeking a balance as a preliminary to economic development.

Steady employment levels in plantation agriculture, limited peasant land and rising population have created a serious underemployment problem on the Island. Sarkar's estimate of underemployment as equivalent to total unemployment of 1.3 million workers seems far too high but in 1955 open unemployment was 67,557 and the Central Bank estimated total unemployment at 500,000 for 1953.[26] With population rising at 200,000 per year an estimated 80,000 workers are added to the labor force annually. As noted above, the Six Year Plan will resettle 143,000 families accounting for about 280,000 workers. Assuming as the program does that 16,000 of the annual labor force increase will be urban this leaves a net increase of rural unemployment (presumably disguised through underemployment) of 116,000 over the entire period. On the other hand, the government estimates that 137,000 workers will be employed in the construction and operation of new projects thereby reducing urban and rural non-agricultural unemployment by over 40,000. Since private investment should absorb perhaps 150,000 workers in the period in question the net over-all effect would appear to be a decrease in unemployment in the neighborhood of 70,000 and a potential labor shortage in the cities if peasants do not develop greater mobility.

One argument for the development of dispersed industry and handicrafts in Ceylon lies in the exact nature of the underemployment. It seems probable that virtually no workers lack jobs either during the harvest peak or the post-monsoon canal repairs. However, these periods last only twelve weeks leaving many workers with no work or considerably less than full-time work during the remaining forty weeks. The achievement of a decent standard of living depends upon some type of employment being

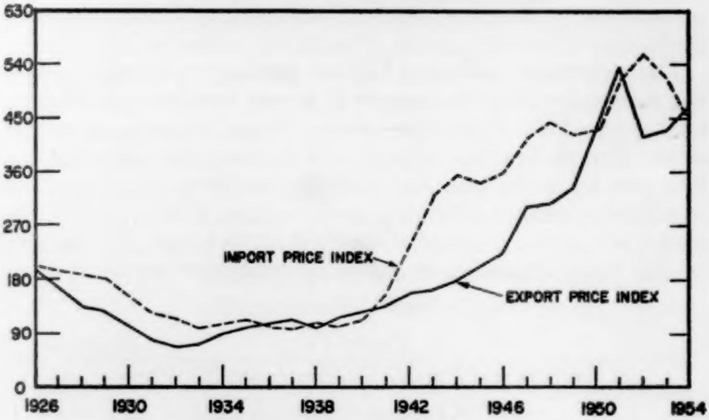
[26] *Programme*, p. 36. The open unemployment figure is probably exaggerated because civil service selection procedures are such that applicants tend to list themselves as unemployed.

developed which will allow them to continue to harvest crops and tend canals while working in non-agricultural positions for nine months out of the year.

CHART III

Import and Export Price Index Numbers

1926-1954 (Base 1934-1938 = 100)



EXPORTS AND IMPORTS

To say that Ceylon's economy is heavily dependent on foreign trade is an understatement. Two of her four major crops are virtually totally exported while cocoanut products are equally important in domestic consumption and international sales. Rice alone is not exported—it is the leading import. Estimates of the share of national income derived from exports run as high as 50 per cent.[27] Under these circumstances the terms and balance of trade are of vital concern to economic planning and policy determination. This is especially true on terms of the development plans which call for over 350 million rupees of foreign capital goods purchases and the raising of over 3000 million rupees in export and import duties.

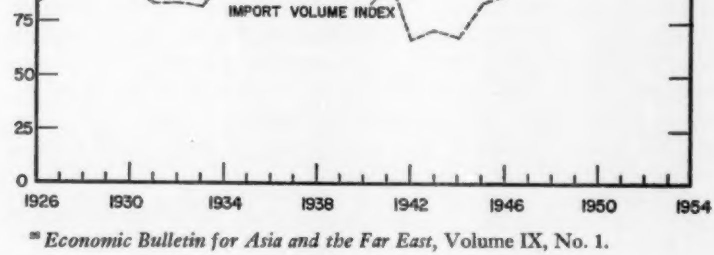
Ceylon's terms of trade have tended to fluctuate from the

[27] B. B. das Gupta, *A Short Economic Survey of Ceylon* (Columbo, 1955).

levels prevailing in 1926, 1934-40, 1952-54 and 1956 with the intervening years seeing poorer terms. Both export and import price numbers have risen but more or less hand in hand. The major exceptions to this trend occurred during the war when price controls and shipping shortages held down the prices as well as the volume of Ceylon's exports and in the post-Korean collapse of primary products. This long-term trend, or lack of one, sheds some doubt on the thesis that primary producers in general have suffered a steady deterioration of their terms of trade.

For a primary producer, Ceylon has been relatively free of the extremely wide fluctuations in export proceeds which have characterized the experience of most Asian countries in recent years. The underlying cause of this semi-stability has been the fact that tea is the least vulnerable of major primary products to wide fluctuations in either price or volume. Unfortunately, the future of Ceylonese export products is not as bright. On the basis of the Paley Report and similar projections[28] the growth of

CHART IV
Import and Export Volume Index Numbers
1926-1954 (Base 1934-1938 = 100)

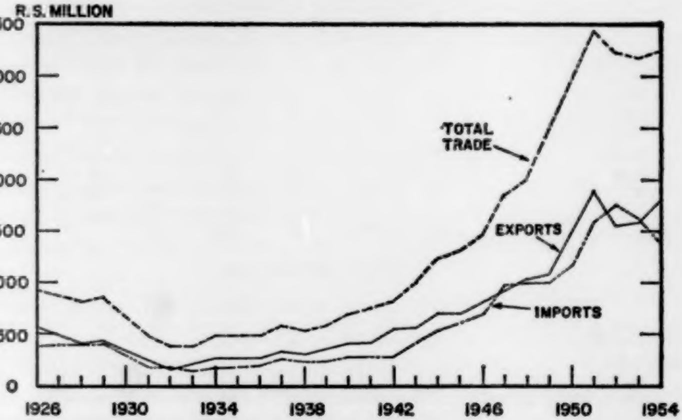


[28] *Economic Bulletin for Asia and the Far East,* Volume IX, No. 1.

Ceylon's current export markets at a rate appreciably above one per cent a year seems highly unlikely. In light of the food and textile import needs alone, and totally discounting capital requirements, such a situation cannot continue tenable in the long run.

Ceylon's balance of trade has been consistently favorable over the past 30 years although wide swings from large surpluses to small deficits have followed fluctuations in world demand. The inauguration of the development plan, increased rice imports necessitated by weather conditions, and the general weakening of tea and rubber prices over the last three years make the recurrence of the 1955-56 record half-billion-rupee surplus unlikely. In the long run, as noted previously, deficits will replace the surplus unless important new exports can be developed.

CHART V
Value of Imports, Exports and Total Trade
(merchandise) 1926-1954



The revenues from import and export duties have, in recent years, accounted for nearly 50 per cent of the government's total income. Since one-quarter of government revenues is derived from state enterprises and other non-tax sources, this

means that duties are twice direct taxes. The import duty is the only tax affecting the average or lower income earner at all as the income tax is steeply progressive with a relatively high exemption level because of its egalitarian and nationalistic motivation.

A breakdown of Ceylon's trade shows tea making up nearly two-thirds of the total exports, rubber one-sixth, and cocoanuts, somewhat over a ninth. There has been a tendency in recent years towards a deterioration in the relative position of rubber and an increase in the share of exports derived from cocoanut products because of the over-all scarcity of vegetable oils. On the debit side, food, particularly rice, is the leading component. Since 1938 imports in constant rupee terms have nearly doubled, imports per capita have remained more or less stable, and food

TABLE 3

Net Balance of Payments Position on Current Account 1938 and 1947-1951 (million rupees)

	1938	1947	1948	1949	1950	1951
Merchandise	38	—118	44	— 16	231	253
Invisibles						
Transport	19	38	53	51	29	35
Investment Income	— 47	— 68	— 49	— 29	— 55	— 65
Private Remittances	— 24	— 25	— 68	— 58	— 69	— 76
Other	— 14	— 7	44	22	1	— 30
Total	— 66	— 62	— 20	— 14	— 94	—136
Net Balance	— 28	—180	24	— 30	137	117

1951-1954 (New Series)

	1951	1952	1953	1954	1955	1956	1957
Merchandise	328.8	—702.2	— 26.0	452.8	480	108	— 90
Invisibles							
Investment Income	— 64.2	— 45.5	— 37.8	— 41.7	(— 40)	(— 40)	(— 40)
Private Remittances	— 77.1	—103.6	— 58.7	65.4	(— 60)	(— 60)	(— 60)
Net Balance Goods, Services, & Remittances	— 89.1	—445.6	—158.3	303.0	(380)	(8)	(—190)

Sources: *Statistical Abstract of Ceylon.*
Central Bank of Ceylon Annual Report.
Economic Survey of Asia and the Far East, 1957.

imports have declined as a per cent of total imports. The absolute increase will continue while the percentage decline will be reversed if the 1957-58 failure to maintain increased rice production per acre and add new areas to paddy cultivation prove to be more than a temporary setback. Investment payments abroad form a smaller share of debits on foreign owners through income and excise taxes and because of the large number of Indian Tamil workers still employed on plantations.

Ceylon's external assets remained virtually constant from 1951 through 1956 at the 1,180,000,000 rupees. While currently adequate, this level of assets will neither finance any very appreciable portion of the development program nor cover a series of sizeable trade deficits. Its adequacy has been increased to some extent in recent years by the conclusion of a number of sizeable closed balance trade agreements by Ceylon, particularly with the People's Republic of China.

This same agreement has, for the time being, solved the marketing problems of Ceylon's rubber industry. Through it the Island has been able to dispose of over half its output at prices above the prevailing world market levels in return for rice provided at relatively favorable rates. One of the more ironic factors in this trade has been that much of the rice is apparently either Burmese rice or rice freed for export by Chinese imports from Burma. Burma meanwhile has virtually lost its prewar rice market in Ceylon because of its withdrawal from the Commonwealth and the lack of any Ceylonese export saleable in Burma. However, this expedient will not serve to cure the basic fault with the Ceylonese rubber industry—that of inefficient small producers and overage trees. Similarly the cocoanut industry will not continue to benefit from the present high prices unless new plantings and combination of holding allow both for the increase in domestic consumption needs and added exports. An examination of trade figures for the period 1951-1958 gives strong evidence to support the thesis that Ceylon's trade balance is far more dependent on the size of necessary rice imports and the prices available for tea, rubber and cocoanuts than on any export factors over which she can exert an appreciable influence. In other words, reduction of imports of consumption goods is not neces-

sarily an autarchic goal but quite conceivably one necessary for the financing of the capital purchases needed for development.[29]

Means to Diversification: Power and Industry

In 1946 11 per cent of Ceylon's labor force was engaged in industrial employment while value added by industrial establishments was 224,600,000 rupees or somewhat under 10 per cent of gross national product. Neither of these figures is impressive in terms of industrial attainment nor has there been very marked progress since that time. The twin keys to the attainment of a diversified economic base and the development of supplementary employment for agricultural workers may lie in the development of the village or cottage shop and production of cheap hydroelectric power. Both appear to be well within the limits of possibility for Ceylon and both are regularly cited as objectives by its planners. As in many other countries, the symbolic value of a steel mill seems to have overridden purely economic considerations but no other heavy industry is planned.

Industrialization is threatened by a shortage of labor, especially of skilled labor. This conclusion, reached earlier from an analysis of population data and job-plan estimates, is also cited in the International Bank Report.[30] However, as previously noted the development of diversified, scattered rural industries producing for the Ceylonese market would allow the use of semi-employed peasants and thereby draw upon resources beyond the utilization of urban firms.

The power situation has been the subject of varying analyses. The International Bank Team was less sanguine than the Programme Staff, although the reasons for their relative pessimism are not clear. Both reports agree that electricity can open the way for efficient, small-scale operations and sidestep the problem of rural immobility. Nevertheless the Bank Reports judgment that "the role of industry need not be minor; yet in view of the local factors, it must remain secondary so long as the land is not well utilized"[31] is both valid and in accord with the actual practice of the Ceylonese government. However, it must be realized

[29] Oliver, *op. cit.*, pp. 25-31.
[30] International Bank, *op. cit.*
[31] *Ibid.*, pp. 521-23.

that the development of industry as a supplement to agricultural employment may be necessary for the effective utilization of both land and labor.

The United Nations' study *Measures for the Economic Development of Underdeveloped Countries* argues, as do Professor Nurkse and other students of agricultural development, that reducing surplus population on the land may be necessary to provide an impetus for the adoption of more effective methods. The Ceylonese and Indian rural development experience would cast some doubt on this position but it is quite possible that increased opportunity costs would lead to more effective methods and labor use. Indeed, it may be true that the development of non-agricultural jobs and the resultant pressure for year-round work on these jobs would force the adoption of techniques designed to lower the peak agricultural labor demand. On the other hand, it is both economically and politically important to ensure that the adoption of new agricultural techniques does not lead to the creation of a landless, jobless proletariat such as that which accompanied the enclosure movement in England and is currently troubling Turkey.

The International Bank Mission and the Development Programme outline a number of areas ranging from cement to bottle caps and from textiles to plywood as suitable fields for economic diversification. The construction of 180,000 tons of cement capacity highlights the progress which is being made in certain areas although the lack of any significant textile industry seems somewhat strange when it is necessary to import over 100 million yards of cotton cloth each year. The Programme's writers contend that special assistance to small producers in buying and selling, organizing rural cooperatives, and restraining foreign competition can lead to scattered and varied industrial developments. Economic opinion on the Island favors a somewhat broader definition of cottage industry on a division of labor, workshop basis as opposed to the International Bank recommendations that it be pursued only at the household level.[32] Support for this position can be found in the prosperity of some central European rural areas which combined farming with small scale industry powered by electricity. Surely if such operations were economi-

[32] *Ibid.*, p. 528.

cally efficient in Europe through 1939, and to some extent today, it seems probable they would be equally valid in Ceylon where there is a pressing need not only to provide supplementary employment but to build up the body of skills which home and village workshops could bring.

In terms of moving workers the "colonization" plans are probably intensifying the existent immobility. Studies in Mexico indicate that dispossessed peasants and non-farm laborers are the best sources for urban industrial labor while farmers benefiting from improvements are the poorest.[33] Agricultural improvements not linked to localized production or processing may, apparently, actually move a society further from industrialization especially to the degree that they merely repeat established patterns with quantitative extensions. Moreover, the village plant has the advantage that it does not require the development of urban facilities, particularly housing, which would place extremely heavy drains on capital, nor at least in its initial stages does it prevent the return of part-time peasants to the land during harvest or diking seasons.

The Ceylonese government feels that the key to the advancement of the rural areas lies in power because without power there will be a definite tendency towards a stagnation of cottage industry at low levels of efficiency and skill development.[34]

More than 80 per cent of the population of the region lives in rural areas. If the objective of raising the standard of living of the common man is to be achieved, the problem to be solved is how to produce more wealth in agriculture and industry and to provide greater opportunities for gainful employment. It is necessary to provide mechanical aid for intensive cultivation and increase industrial production. The need for resuscitating the cottage industries to provide remunerative employment for the peasantry during the off season is stressed. The desirability of dispersing industries for providing employment to the unemployed is pointed out.

Electricity can provide one of the most effective means of solving this problem. The realization of industrial potential and agricultural development are closely related to the success of rural electrification programmes. . . . The rural loads are scattered. The demand

[33] Wilbert E. Moore, *Industrialization and Labor* (Ithaca, 1951), p. 304ff.
[34] *Programme*, pp. 277-92.

per customer is low, owing to the low standard of living, and it is difficult to supply power at economic rates for such small and scattered loads. The problem in fact offers a challenge and an oportunity to the engineers and administrators of the power-supply industry; a satisfactory solution will depend on the ingenuity and professional skill they bring to bear upon it, and also on the cooperation they secure.

This section from the United Nations Report on Rural Electrification in Asia sums up the challenge Ceylon faces and feels it is about to meet. Rural electrification on the basis of developing hydroelectric power and the construction of transmission lines to all villages near the present island-wide grid, and eventually to all villages, is an integral part of the Six Year Plan.

Institutional Patterns: Channeling Funds to the Small Entrepreneur

Institutional patterns can always be made into an explanation of economic development—or more commonly non-development. As such they sometimes say little more than that the writer is aware that everything influences everything else and is unable to identify the key variables. On the other hand, specific institutional elements can be cited as key bottlenecks or channels inhibiting or promoting change. In Ceylon, four institutional elements appear especially noteworthy and clear in their economic implications. These are lack of technical knowledge, land-title clouding and fragmentation, with its related structural lending problems, lack of confidence on the part of the Ceylonese businessman, and the difficulty encountered in mobilizing savings on behalf of the small investor. Labor immobility and the absence of a desire for economic change are deliberately excluded because the former has been treated in terms of industrialization and agricultural development while the second does not appear to be a genuine obstacle in that the possibility of economic betterment is grasped when seen by the average Ceylonese.

In most fields, the rate of economic development is actually limited less by finances than by the lack of local technology at all levels. To carry out the various projects there are not enough research scientists, designing and operating engineers, agricultural or manu-

facturing specialists, or construction engineers. Equally scarce are technical supervisors, draftsmen, control chemists, field foremen, tractor operators, and even skilled workmen. To remedy this must be one of the first tasks.[35]

Lack of opportunity, a colonial educational system, a colonial hierarchy which reinforced the caste system by placing the civil servant and clerk above the technician—the causal factors are both observable and numerous. Overcoming them is more difficult. The International Bank and the Programme stress the need for education, for basic research, for community extension work. These areas sound drab but as the rice and cocoanut development programs indicate, they can lead to more spectacular returns per rupee than the most productive of investments measured in the normal c/o ratio tables. John Stuart Mill's dictum concerning the maximal rather than minimal productivity of so-called "sterile" expenditures by government was never clearer than in education and research in underdeveloped areas and with technologically backward peoples.

Experience in Ceylon and elsewhere in Asia suggests that technicians, beginning with doctors, can gain status and prestige and that research can be accepted if actual demonstrations are performed under typical conditions by semi-resident development personnel. Success and example are powerful teachers especially when operating in the context of an already tottering traditional value pattern.

Land titles in Ceylon are in almost as chaotic a condition as in parts of the Middle East where Egypt's fragmented Nile Delta is no more overdivided than parts of the Island. These two situations combine to raise serious barriers to development. Funds and time are wasted in litigation, in walking between divided parcels, in uneconomically small marketing units, and in the usually unsuccessful attempt to secure funds for capital improvement. H. S. F. Goonewardena, General Manager of the Agricultural and Industrial Credit Corporation of Ceylon states:

Unsound titles or titles that cannot be accepted as legally valid constitute the main problem confronting any lending institution in

[35] Rosen, *op. cit.*, p. 790.

Ceylon. A final solution to this problem is dependent on the establishment of a system of registration by titles, and its effective operation will be conditioned by the practice of unrestricted fragmentation and absentee ownership.[36]

Alternatively, the government could guarantee all titles not currently in dispute providing security for lenders and purchasers in good faith. This would eliminate the situation in which 794 out of 1670 agricultural loan applications were withdrawn because of irremediably defective titles. It was and still is quite unusual for the expense of clearing title to reach 300 rupees, a staggering cost to the small holder seeking a 3000 rupee loan.[37]

The International Bank Mission supported introduction of the Torrens system and positive governmental action to prevent fragmentation and especially the disintegration of the economic unit in the case of rubber and tea plantations which have come into Ceylonese ownership. The government is aware of the problem, but beyond restricting subdivision of alienated crown land and colonization allotments appears to be doing, and planning to do, little.

Ceylonese capitalists are neither particularly numerous nor particularly self-confident. They have sought and obtained government protection from foreign competition extending to the prohibition of non-Ceylonese firms in some areas. This program has not been a notable success for the simple reason that the same lack of initiative which has deterred the entrepreneurs from entering into competition with foreign merchants tends to make their exploitation of special opportunities either ineffective or grossly monopolistic. In view of the Island's limited capital and entrepreneurial supplies, it would seem a far better policy to encourage foreign businesses except in those areas in which existing or seriously projected firms promise to become as efficient as foreign business in the immediate future but need, or feel they need, temporary protection from competition.[38]

The problems involved in Ceylon's lending and borrowing structure are by no means homogenous. Established firms and the government are able to secure equity capital and loans at

[36] *Mobilization of Domestic Capital*, ECAFE (Bangkok, 1953), p. 198.
[37] *Ibid.*, pp. 194-200.
[38] Oliver, *op. cit.*, pp. 117-23.

rates which are reasonable by Western commercial standards, ranging from 6.0 per cent return on brewery stock and 13 per cent on tea plantation shares to 2.9 per cent on fifteen year National Loan notes. These rates are applicable only to borrowers with first rate security. The collateral requirements of lenders offering funds at reasonable rates are as much, if not more, of an obstacle to the small borrower as the sky-high rates charged by the semi-pawn broking markets which are open to him.[39]

Though there has been much wishful thinking on these matters, little has been done to remedy the problems. The cooperative movement and government purchases and sales aid schemes for small producers are virtually all that is available to the small land owner or businessman. The Credit Corporation in the ten years from 1943 through 1953 lent only 33 million rupees to 635 agricultural applicants and 4 million to 92 industrial borrowers.[40] All too clearly the former item went largely to plantation owners, since small farmers would scarcely need loans averaging 50,000 rupees. The industrial loans' average size of 40,000 rupees seems reasonable but the total amount is so minute as to be virtually insignificant. More progress might be expected were attempts made to bring savings and investments closer in order to mobilize increased agricultural revenue from higher yields and colonists and by securing the release of hoarded gold and silver for the development of local industries. Similarly public investment might be stimulated and the preconditions for successful village industry developed by utilizing surplus workers on a voluntary or minimal pay basis in constructing roads, schools, and irrigation works for their own communities.

Such channeling has the appeal of providing tangible evidence to the investor that his money is being used well and to the worker that his contribution will provide something of value to him and his family. As Professors Nurkse and Aubrey have pointed out such visual evidence may well be necessary to mobilize potential investment funds which will otherwise go into gold, ritualistic consumption or bidding up land prices.[41]

[39] *Mobilization, op. cit.*, 194-200.
[40] *Ibid.*
[41] Henry G. Aubrey, "Small Industry in Economic Development," *Social Research*, May, 1951, pp. 269-300.

Investment Coefficients and Income

The study of South Asian capital requirements is still in its initial stages. Saiiyid Abbas' pioneer study is a provocative work but seems unlikely to stand up as a definitive guide. The pessimistic conclusions drawn by him are based on capital-output ratios considerably above those logically derivable from his data and those which Kuznets' study indicate for the United States. A total failure to recognize the possibility of raising output with capital remaining constant increases the general gloom of the study. Table 5 takes Abbas' model, adjusts for "social

Table 5
Tentative Potential Plan Results

	1955-56	1956-57	1957-58	1958-59	1959-60
Income (rupees)	5,104 M	5,372 M	5,644 M	5,920 M	5,602 M
Population	8,600,000	8,800,000	9,000,000	9,200,000	9,400,000
Income/Capita	593	610	627	643	660
Increase in Population	200,000	200,000	200,000	200,000	200,000
Increase in Working Force	80,000	80,000	80,000	80,000	80,000
Government:					
Resettlement	46,650	46,650	46,650	46,650	46,650
Non-Agricultural added Employment	22,500	22,500	22,500	22,500	22,500
Added Employment Private[b]	30,000	30,000	30,000	30,000	30,000
Change in Unemployment	—19,500	—19,500	—19,500	—19,500	—19,500
Government I[a]	330 M	330 M	330 M	330 M	330 M
Private I[c]	150 M	150 M	150 M	150 M	150 M
c/o Ratio	2.5	2.5	2.5	2.5	2.5
Additionally (for next year)	192 M	192 M	192 M	192 M	192 M
Additional Productivity[d]	1.5%	1.5%	1.5%	1.5%	1.5%
Additionally (for next year)	76 M	80 M	84 M	90 M	93 M

[a] Adjusted for Social Capital.
[b] Based on capital/labor of 5000 rupees/new job.
[c] 1952-54 Gross average divided by two.
[d] Minimal estimate; e.g., rice yield 7 year average 1947-54 over 3.0% increase.

capital," introduces c/o ratios based on available Indian and Ceylonese data, utilizes relatively conservative estimates of government and private investment, but yields a much more favorable result. Certainly some modification of the data in the study seems necessary because given its ratios and the known level of investment in Ceylon it is utterly inconceivable that income per capita has risen since 1947 rather than experiencing a sharp decline.

However, no particular claim for accuracy is advanced on behalf of the data in Table 5. While several are arbitarily selected in terms of the least favorable possible position, the entire trend of income could be sharply shifted or reversed by international commodity price movements continuing over a series of years. The strongest point which can be made is that far more research is needed before capital-output ratio analyses of South Asian economics will become even relatively exact. More information is needed on the productivity of funds devoted to education, public health and technological development. Ceylon's net capital creation data are little more exact than the "applicable" coefficients. Private investment is available only in gross figures; presumably government development plan spending is over and above maintenance and replacement of current investments. The stability of the money supply and the price level in recent years contrast sharply with the erratic flow of productively utilized savings. Little can be said about the propensity to save although it might be argued that there is some evidence for saying that it is rising (or that savings are being recorded and estimated more accurately?).

Available ratios are virtually over-all rather than marginal while marginal c/o ratios would appear to be more relevant for purposes of development planning. It is also necessary to shed light on the fact that capital output ratios are remarkably similar between countries and between the same industries in different countries, a combination seemingly at variance with the wide c/o variations from industry to industry and the extremely different makeups of the output of different countries. Why should Denmark have a higher non-agricultural capital-output ratio than the United States and why should India's appear virtually identical with that of the United States in non-agricultural areas but markedly higher in agriculture? Such information raises as many

questions as it answers and appears highly dangerous for simple application to differing situations.

The Ceylonese plan estimates the c/o ratio at 2.5[42] which appears at least possible in terms of available data on Indian development magnitudes. Actually the Ceylonese estimates range from 1.5 to 3.0 and clearly include the use of improved techniques which are not a legitimate part of the standard c/o ratio since they could, at least in theory, be employed by reorganizing present resources without the addition of more capital. Available data on industrial investment and value added gives a 1.54 c/o for the industrial sector of the economy—an impossibly low figure, obviously biased downward by the exclusion of overhead capital cost and possibly by the underlisting of assets.

Productivity in rice growing has been advancing by over 3 per cent per annum, progress in improving cocoanut yields reportedly have been equally marked. Thus a "technical increased efficiency of resource utilization" function of 1.5 per cent per year seems a reasonable estimate for the economy as a whole. Combining the 2.5 c/o and the 1.5 per cent annual technical efficiency increase with government planning data and conservative estimates of private investment yields the results shown in Chart V implying *ceteris paribus* that the additional labor force could be absorbed and that income per capita should rise from three to four per cent a year.

Even the sketchy data now available point to serious and probably increasing problems in terms of the mobilization of capital. The static level of savings deposits since 1952, the propensity to purchase and hoard land noted by Sarkar and others, and the paucity of capital available to the small entrepreneur strongly suggest a failure to provide adequate channels from saver to investor. Wolf and Suffrin cite cases in which incentive programs have led to marginal propensities to save as high as 60 per cent in rural areas at least as poor as Ceylon.[43] Either the development of such programs or the application of taxes designed to drain increased agricultural income into government investment seems called for. With the Ceylonese government's universally bad reputation as a business operator the former al-

[42] *Programme*, pp. 493-501.

[43] Wolf and Suffrin, *Capital Formation and Foreign Investment in Underdeveloped Areas* (Syracuse, 1955), p. 13.

ternative seems definitely preferable. The government should, however, consider sharp increases in the rent of development project farms which now average from under one-half to a quarter as high as the prevailing 50 per cent of crop rates on privately owned paddy farms. The money supply which has paradoxically tended to remain stationary or decline in recent years might be expanded to some extent through increasing monetization of the economy without creating severe inflationary results although that particular type of financing is rather hard to control effectively or keep in check once begun.

The Rise of Planning

Planned development is by no means new in Ceylon but its growth into an over-all detailed approach to the economic problems confronting the Island can probably best be dated from the appearance of *Post-War Development Proposals* in 1946. Compared to the *Six Year Programme of Investment 1954/55-1959/60*[44] which appeared nine years later, it seems a collection of projects rather than a synthesized one. The intermediate steps are the International Bank Report *Economic Development of Ceylon* and the various publications of the Columbo Plan.

The International Bank Proposals and those of the Six Year Programme are in general very similar. Comparison of the two plans reveals the impact of the Bank's Mission on Ceylonese planning. It is interesting to note the substantial increase in over-all goals from 1.6 billion rupees in seven years to 2.5 billion in six but it is even more interesting to analyze the distribution of the additional 900 million. Over half was allocated to agricultural development, almost a quarter to power, only a sixteenth to public welfare projects such as housing and barely a thirtieth to industry. These figures contrast with the somewhat leftist and nationalist tendencies often discernible in Ceylonese economic literature and unofficial proposals and to some extent with the professions of both the former Katelawala and the present Bandaranaike governments. The major criticism which an orthodox economist could level at the plan is that it overstresses short-term strengthening of the current economic base and slights long-

[44] Government Press (Columbo, 1946 and 1955).

term broadening and social capital investment. This attitude of realism and, at least by Asian standards, conservatism in terms of action also pervades Ceylonese attempts to secure national control of their economy. There has been no direct nationalization of foreign holdings despite statements calling for such action although there has been considerable encouragement to plantation owners to sell out to Ceylonese. While both duties and income taxes have been designed to ensure that foreign investments provide revenue to the Ceylonese government and are not excessively profitable they have not been so extreme as to result in the flight of capital. Finally, the government's program even under the Bandaranaike government has tended to steer away from large scale state enterprise both because of bad experience and a lack of real enthusiasm for undertaking such programs.[45]

TABLE 6
Six Year Programme Expenditures

(Rs '000)

Total	2,538,786	100%	
Defense	94,623	3.74	
Administration	89,477	3.54	
Social Services	402,738	15.93	
Health	116,369	4.68	
Education	146,101	5.78	
Housing	105,131	4.16	
Economic Projects	1,941,948	76.79	% of Economic Projects
Utilities	837,621	33.12	43.13
Agriculture, Irrigation, and Fisheries	922,602	36.48	47.51
Industry	111,799	4.42	5.76
Rural Developments	57,550	2.28	2.96
Tourism	12,376	.49	.64

Source: *Six Year Programme*, p. 23.

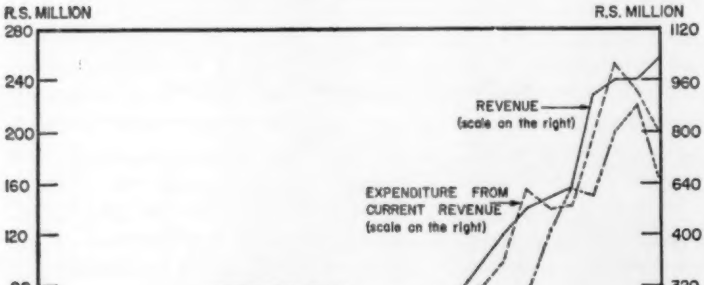
Financing Ceylonese economic development was through 1956 a relatively simple matter. The International Bank estimates place available funds at from 180 to 320 million rupees annually while an examination of 1953-55 revenue and expenditure patterns suggests somewhat greater magnitudes. Indeed under-expenditure rather than an inflationary gap characterized the Kate-

[45] Oliver, *op. cit.*, pp. 21-25.

lawala government. Here there has been a change as the Bandaranaike budgets have been pushed into the deficit category by the reintroduction of rice subsidies to ensure low costs for the staple commodity.[46] On the whole Ceylonese financing, like Ceylonese planning, is relatively sound according to the canons of orthodox political economy. On the other hand, the Programme also clearly represents the results of extensive original thought and the application of economic principles to Ceylon's particular problems and prospects not an uncritical acceptance or imitation of Western European practice.

CHART VI

Revenue and Expenditure–1926-1954



It should be noted that Ceylonese policy and experience cannot be fully generalized in terms of South and Southeast Asia. The Island has a better trade position, higher per capita income, a more efficient civil service, and possibly a more adaptable population than most of her neighbors. In addition, her ability to re-

[46] From the point of view of the Ceylonese there has been inflation since the war although the price level has now remained relatively stable for several years. However, the price changes have been the result of the international commodity market fluctuations acting on Ceylon's open economy and have in general been paralleled, or at worst lagged, by wage increases as the prices received for Ceylon's exports have risen.

claim land, develop cheap electric power, and adopt agricultural techniques already proven effective in other Asian countries give her almost unique advantages which are being exploited with substantial effectiveness. Since the highly inaccurate statistics and ratios available for Ceylon indicate that her standard of living is rising but that this rise is contingent upon at least neutral, if not favorable, changes in international commodity prices and quantitative demand, it seems logical that the model's application elsewhere would yield results totally consistent with ECAFE's Spring 1956 conclusion that income per capita was rising appreciably only in Ceylon, Japan, Thailand and the Philippines, while remaining static or falling in other South Asian nations.[47]

Comments and Conclusions

This account of Ceylon's economic structure and development plans has ignored certain major socio-economic factors such as the caste system and even some important elements in economic policy such as the tariff structure assuming that the status quo has been maintained in both cases. It has been assumed that on the whole the Ceylonese do want more real income per capita—a conclusion which is strongly supported by the evidence cited in Henry Oliver's *Economic Opinion and Policy in Ceylon*. On the basis of these assumptions and available data on existing economic levels and their trends certain conclusions and comments may be attempted. Ceylon must achieve rising standards of living and incentives to reduce the size of families speedily enough to prevent the population from passing the point at which natural resources are no longer capable of providing an acceptable income per capita set arbitrarily at $1000 per capita. This means that while the economy is at present sound the long-term outlook is considerably less favorable. To attain the requisite increase in living standards and changes in attitude before it is too late Ceylon must develop or adapt better techniques both in agriculture and industry and educate her people to their use. Non-agricultural rural employment and production of a wide range of goods for home consumption and

[47] "Asia's Economic Forward March," United Nations Review, March, 1956, pp. 18-21, 23.

possibly for the South Asian market must be developed. These are the two basic elements in the creation of a dynamically viable economy for the Island.

The need for basic research in agriculture and small-scale industry is obvious. Ceylon is living on borrowed techniques including those adapted from lands whose inferior natural resource endowments have forced them to be more efficient in their employment. These "advantages of backwardness" necessarily disappear with backwardness. Research in rural development must seek to develop a Ceylonese counterpart to the United States Agricultural Extension Service which, as Professor Galbraith has pointed out, serves as a key factor in bringing about rapid technical and technological progress in United States agriculture. Finally, research in economic policy is highly desirable in order to establish more definitely the functions, factors, and magnitudes relevant for economic planning and prediction and to calculate more accurately the quantitative results of social capital investment in education and public health. It should be possible to determine whether preventive medicine is a productive investment which raises worker output or a negative factor which increases unemployment and non-productive consumption. This would put an end to debates on the issue at least in terms of specific contexts.

Rural employment must be raised as must food production. These two requirements are not necessarily complementary as improved techniques may permit fewer farmers to produce more crops. While the "colonization" of the dry lands could provide added food for a number of years, some other policies such as increasing productivity in paddy cultivation, replanting overage cocoanut and rubber trees, and interplanting rubber and cacao probably have greater long-term potential. It is in any case patently impossible for the current agricultural population to find full employment on the land. When combined with the fact that much underemployment is seasonal the transfer costs of rural labor militate against centralized industrial centers and in favor of village or cottage workshops.

Such workshops must be developed in terms of modern power sources and improved techniques if they are to be of lasting value. If they are so planned and developed they can pro-

vide sources of rural employment, economical products for the home market, and an effective way of diffusing skills and increasing mobility. In addition they probably offer the most hopeful method for tapping increased peasant earnings from agriculture since the residents of each village could then finance their own workshop. In the case of Ceylon the choice is not between village industry and factories in the American sense of the word. It is in all probability between village industry and subsistence agriculture. Given that choice the better alternative is clear. The key to the revival of small plants as efficient economic units since the mid-nineteenth century has been electric power. The speedy development of electric power dams and distribution networks and the more general use of electricity by village workshops could trigger a cumulative development of secondary and tertiary industry on the Island.

Institutional reforms must be made in landholding, land title, and lending policy. That such changes will be expensive is not necessarily a reason for avoiding them. The continued obstruction to economic development and in particular to the improvement of small landholdings or small industrial establishments which the current institutional framework presents is in the long run likely to prove very much more expensive. Uneconomically small parcels of land should be combined, legislation preventing the division of landholdings when such action reduces plots to less than one acre should be passed, small scale absentee ownership needs to be discouraged. Titles for all landholdings not now in dispute should be guaranteed as the first step toward introducing a comprehensive title registration policy. These two reforms will lead to an immediate increase in output for technical reasons and will allow capital to flow into agriculture more readily by providing immeasurably better security for the lender.

It is equally important that a fund of at least 100 million rupees be established to provide small loans to progressive farmers and to small entrepreneurs, both actual and potential. Loans should be based on the probable ability to utilize them effectively rather than on collateral and a low interest rate should be combined with medium term loans. Such a corporation should not seek to pursue policies leading to a perfect credit record since a body initiating economic development is likely to make

some mistakes unless it lends only on "sure things" which do not need its assistance in the first place.

Ceylon's industrial and export potential must be evaluated carefully. Potentially large-scale and potentially integrated industries such as the cotton cloth trade should be given special consideration. The possibility of developing cocoanut products or cacao into food exports to Asia's protein-deficient countries might afford a way out of the impasse facing tea, rubber, and soap grade cocoanut products.

It is in the context of action on these fronts that a sustained increase in national income and of income per capita can be achieved. Ceylon's experience and the tentative magnitudes deducible from current data lend credence to the belief that such progress has begun and may be continued at a rate of 3 per cent per annum. This should be ample to demonstrate the possibility of economic progress to educated citizens and therefore to create real interest in limiting family size and population increase. So far as Ceylon is concerned there is no reason to accept the thesis that Asian economic development is a mirage or that ambitious goals are unattainable. Indeed, it may well be that *only* ambitious goals can be obtained, more modest ones being too little and too late to win the race which increasing standards of living must run with the population increase in South and Southeast Asia.

SOME ASPECTS OF FOREIGN INVESTMENT AND ECONOMIC GROWTH IN LATIN AMERICA

*Richard D. Mallon**

It is generally agreed that one of the most effective ways for the advanced countries to assist the economic growth of the less-developed nations is to bring about a greater flow of investment from the former to the latter. But there is a large area of disagreement and considerable confusion concerning the nature of the benefits and the most advantageous forms of foreign investment. Those who consider foreign investment chiefly as a means of redistributing income from the rich to the poor nations, for example, soon become disenchanted when they realize that the inflow of capital can keep ahead of the outflow of service payments only so long as the rate of increase of new investment exceeds the average rate of amortization plus interest and/or of profits remittances.[1] Also there are those who consider private foreign investment simply as a form of foreign exploitation which leads to a severe drain on foreign exchange resources, whereas on the other extreme it is thought that private investment can and should substitute almost completely for official aid and loans.

Although the list of controversial issues could be extended greatly, in this study three aspects of the relation of foreign investment to economic growth in Latin America will be discussed: (1) The financing of essential or social overhead services; (2) The impact of foreign investment on the balance of payments of receiving countries and (3) The transfer of improved techniques and skills.

Analysis of these points will not only throw some light on issues like those mentioned in the first paragraph, but it is intended to show how foreign capital can be of special benefit to countries in an intermediate stage of economic development and which thus

* Most of the research for this study was carried out by the author while employed by the U.N. Economic Commission for Latin America in Santiago, Chile. He would also like to express his appreciation to Professor David Bell of Harvard University who assisted greatly with the revision of the original draft.

[1] See E. D. Domar, *Essays in the Theory of Economic Growth*, (Oxford, 1957), Chapter VI, for a clear statement of this relationship.

do not require a large injection of capital to assist a "take-off" or an initial "big push." In general, Latin American countries have far from exploited their full domestic savings potential and can hardly claim that external funds are indispensible to supplement an over-all shortage of domestic savings. Furthermore, since foreign investment is generally on a much smaller scale today than it was in the nineteenth century, the strategic importance of a moderate, selective international flow of capital is an especially appropriate frame of reference for the study of the contribution of foreign capital to the economic growth of the region. Before taking up the three aspects enumerated above, it is therefore necessary to describe first the special characteristics of the Latin American economic environment which set it apart from other underdeveloped areas and the current role being played by foreign investment.

The Latin American Economic Environment

Sometimes it is thought that a massive movement of capital from developed to less-developed countries is indispensable in order to move these countries off the dead center of poverty and low savings. However, the idea that lower income countries are necessarily low saving countries is not supported by statistical evidence, which shows that there is no particular correlation between per capita income levels and savings coefficients.[2] Furthermore, the expression "saving" in this context is an *ex post* concept referring to that part of income which has been used to finance capital formation and is not necessarily a measure of the savings capacity of a community, unless the other 90 per cent or so of income not put into capital formation is assumed to be non-compressible. Although this could be the case in countries where most income goes to maintain the mass of the population at a bare subsistence level, this is not the general situation in Latin America.

Considerably less than half of gross income is usually paid out in salaries and wages in Latin American countries, the remainder

[2] See, for example, the table in the paper presented by Mervyn Weiner of the International Bank at the Fourth Meeting of Technicians of Central Banks of the American Continent, *Proceedings*, Vol. 1, (Washington, 1955), p. 300. See also C. P. Kindleberger, *Economic Development* (New York, 1958), pp. 51-52.

accruing to recipients of profits, rent and interest and in lesser measure to the self-employed. Since most of the savings of capitalistic societies are accumulated by these recipients, it would appear that income distribution is more favorable to saving in the region than in the more advanced countries.[3] In the United States and Great Britain, for example, wages and salaries absorb fully two-thirds of national income, and the share of profits, interest and rents fluctuates around 20 per cent. Taxes on these incomes are also generally higher than in Latin America.

Far from being caught on dead center, during the postwar decade 1946-55 the increase in the region's real gross product has been estimated at a bit over 60 per cent, the individual figures for Brazil, Mexico and Colombia being closer to 70 per cent.[4] These increases are several times as large as population increments, even though the rate of population growth in the area is among the highest in the world. The postwar record of Latin America compares very favorably with the decade average rates of growth in real gross product which have been estimated for some seventeen countries over the last 50 to 100 years.[5] The highest recorded rate of 56 per cent is for the United States between 1869 and the beginning of the First World War, whereas only three other countries have been able to maintain rates of over 40 per cent per decade (Canada, Japan and South Africa), which is the postwar increase in Argentina and Chile, two of the countries in Latin America in which economic growth has slowed down or stagnated in recent years.

It is true that a rapid rate of growth during an exceptional decade when the external terms of trade were moving extremely favorably is not on the same footing with the sustained decade average rates used for comparison. Also, in spite of the substantial expansion in income, the proportion dedicated to fixed capital did not increase between 1946 and 1955, and the share of the pri-

[3] The greater use of the corporate form of business organization in highly industrialized countries of course enables a larger part of income to be withdrawn for reinvestment before being distributed to persons than in countries where this form of organization is not so frequently employed.

[4] Unless otherwise noted, all the statistics cited on Latin America are taken from the publications of the U.N. Economic Commission for Latin America, principally the annual *Economic Surveys*.

[5] Simon Kuznets, *Economic Development and Cultural Change*, University of Chicago, Vol. V, No. 1, October, 1956, pp. 10 and 13.

vate sector fell from 80 to 70 per cent of total investment.[6] Thus, while it is correct to say that most of the Latin American population is not living in countries struggling to raise per capita income above the bare subsistence level and in which domestic savings and purchasing power are so low that any significant improvement must come about by means of large-scale foreign investment or extreme hardships imposed on the mass of consumers, it would be rash to say that a number of the Latin American republics are already successfully launched on the road to self-sustained growth. Some of the existing obstacles must be attacked primarily from the domestic side by monetary and fiscal policies and other measures aimed at making consumption less and saving more attractive and at limiting monetary expansion. But in so far as the basic difficulties are the existence of bottlenecks, lack of perception of investment opportunities, or institutional rigidities, then foreign enterprise, capital and technical knowledge may have a significant contribution to make in broadening the opportunities available for the profitable investment of domestic capital.

Recent Foreign Investment Experience

The present day environment for international capital movements is quite different from what it was in the nineteenth century. In the first place, economic development in the dominant industrial centers—notably the United States and the Soviet Union—is more self-contained and not so dependent upon the supply of foodstuffs and raw materials from abroad. This is partly attributable to policies, both in the centers and elsewhere, which have increased obstacles to the free movement of goods and people; but it is also due to factors peculiar to world economic development which have worked in the same direction, such as the vast internal availabilities of land and resources in the newer industrial centers, technological improvements the net effect of which has been to reduce the amount of materials inputs per unit of industrial output, and changes in the composition of final demand favoring services and more highly elaborated goods.[7]

[6] U.N.-E.C.L.A., *Economic Survey of Latin America, 1955*, Table 8, p. 9.

[7] See, for example, U.S. Department of Commerce, Bureau of Foreign Commerce, *Business Information Service, World Trade Series No. 632*, September, 1954, pp. 4-6.

Second, world events have not been conducive to the financing of a large flow of international capital. First the world depression, then military outlays, and finally expenditures on postwar reconstruction and defense, in addition to the widespread distrust in foreign investment bred of the experiences of the 1930's and problems of exchange inconvertibility and instability, have reduced the share of domestic savings which the centers have been able or willing to send abroad.

As a result, foreign investment since World War II has by and large represented a much smaller share of total capital formation in recipient countries than in those areas opened up by foreign capital in the second half of the last century, and the destination of this capital has changed quite radically. The bulk of foreign investment before World War I was in government bonds and public utilities(especially railroads),[8] whereas today international financial institutions are the major if not the only source of foreign funds for these purposes. Private capital now exported by the centers to underdeveloped areas has been going mainly to promote the production of a limited number of raw materials for which world demand has been growing with particular force (notably petroleum), and to non-primary activities providing for domestic consumption in capital receiving countries, usually of the same types of goods which the capital exporters sell in world markets but are unable to place competitively in local markets because of import restrictions.[9]

To be more specific, the composition of postwar (1946-55) United States investment in Latin America has been as follows: petroleum 31 per cent, manufacturing 28 per cent, mining and smelting 15 per cent, trade and miscellaneous also 15 per cent, with the remainder going to public utilities and agriculture. Thus, about half has gone into production principally for export (petroleum, mining and smelting, and agriculture) and half into output for domestic consumption (manufacturing, trade and miscellaneous, and public utilities).[10]

[8] See Royal Institute of International Affairs, *The Problem of Foreign Investment* (London, 1937).

[9] R. Mikesell, *Promoting U.S. Private Investment Abroad* (National Planning Association pamphlet, 1957), p. 29, text and footnote 1.

[10] U.S. Department of Commerce, *Survey of Current Business*, selected numbers.

TABLE I

Composition of Gross Fixed Investment in Selected Countries

(Percentages of total)

	Mature countries									
	United States		West Germany	Denmark	U.K.	Italy	France	Norway	Sweden
	1946-50	1951-55	1950-54	1950-54	1948-55	1950-54	1950-54	1950-54	1950-54
I. *Social overhead*	*47*	*53*	*51*	*52*	*55*	*55*	*60*	*64*	*68*
A. Dwellings (non farm)	21	22	25	16	23	20	24	17	24
B. Public utilities	13	13	20	27	22	24	25	39	34
1. Transport, commun.	6	5	11	22	11	15	16	32	25
2. Elect., gas, water	7	8	9	5	11	9	9	7	9
C. Government (mainly public construction)	12	17	6	9	10	11	11	8	10
II. *Directly Productive*	*53*	*47*	*49*	*48*	*45*	*45*	*40*	*36*	*32*
A. Agriculture	9	7	9	14	5	13	10	10	7
B. Mining, manufact.	25	24	32	27	30	26	24	19	23
C. Trade, services	19	16	8	7	10	6	6	7	2

	Developing countries							
	United States		Canada		Argentina		Greece	Puerto Rico
	1850-80	1880-1900	1901-15	1916-30	1900-14	1945-54	1950-54	1950-54
I. *Social overhead*	*53*	*61*	*52*	*51*	*67*	*65*	*52*	*59*
A. Dwellings (non farm)	29	35	16	18	35	29	25	23
B. Public Utilities	(20)	(19)	27	22	19	16	23	19
1. Transport, commun.	(15)	(11)	24	18	17	14	13	—
2. Elect., gas, water	(5)	(8)	(3)	(4)	2	2	10	—
C. Government (mainly public construction)	4	7	9	10	14	20	4	17
II. *Directly Productive*	*47*	*39*	*48*	*49*	*33*	*35*	*48*	*41*
A. Agriculture	24	10	18	9	14	10	9	—
B. Mining, manufact.	(23)	(29)	(30)	(40)	15	20	19	—
C. Trade, services					4	5	20	

Note: The classification of fixed investment corresponds to that contained in the United Nations *Economic Survey of Europe 1955*, so that the data are more comparable for the countries for which this source was used. Non-fixed investment in livestock and permanent crops is included in agriculture for most of the "developing countries."

For the United States and Canada prior to World War I, the distribution between public utility and other industrial investment is somewhat arbitrary. After World War II, U.S. investment in communications is included in trade and services, and some government investment corresponds to public utilities. For the Scandinavian countries, the general practice is to include maintenance charges in public utility investment, so that percentages corresponding to this classification are exaggerated in comparison with other countries.

Sources: Western Germany, Denmark, Italy, France, Norway, Sweden and Greece: *Economic Survey of Europe 1955*, United Nations E.C.E., pp. 38-39. Data in current prices.

U.S.A. 1946-50 and 1951-55: *Economic Report to the President*, Jan. 1956, appendix tables D-7, D-29 and D-31. The percentage composition of new plant and equipment expenditures in table D-29 was applied to the corresponding total in table D-7. Government investment refers to public non-military construction (table D-31). Data in current prices.

United Kingdom: *National Income and Expenditure 1956*, General Statistical Office, p. 47. Data in 1948 prices.

Canada: *Capital Formation in Canada, 1896-1930*, Kenneth Buckley, 1955. The figures for public utility investment other than transportation are probably underestimated. Data in current prices.

U.S.A. 1850-80 and 1880-1900: Net additions to reproducible tangible wealth in 1929 prices as estimated by Raymond Goldsmith in *Income and Wealth of the U.S.*, Income and Wealth Series II, pp. 306-7. Figures exclude non-farm business inventories, gold and silver, net foreign investment and consumer durable goods. The distribution between public utilities and other non-agricultural business investment was based on estimates of changes in public utility capital by Simon Kuznets (*Historical Statistics of the U.S. 1789-1945*, U.S. Dept. of Commerce, p. 9) and the per cent of gross investment dedicated to railroad construction (*Trends and Cycles in Capital Formation by U.S. Railroads 1870-1950*, Melville Ulmer, p. 11).

Puerto Rico: S. L. Descartes, *Savings and Investments in Puerto Rico*, 1956, p. 138. The figure for public utilities corresponds to investment by Commonwealth business enterprises, except for public housing, which was included with private residential construction in dwellings. These enterprises have invested mainly in transportation, communications, electricity and water, although investments in general development and welfare are also included. Data in current prices.

Argentina: United Nations E.C.L.A., *Economic Development of Argentina*. Data in 1950 prices. For 1945-54, transport and communications include investment in transport only, whereas communications are included with electricity, gas and water.

Recent trends in international capital movements, however, do not impose severe limitations on the economic growth of the countries in which the majority of the Latin American people live. These countries can be considered to be in an intermediate stage of economic development, in which the money economy far outweighs the subsistence sector and production is becoming increasingly diversified and mechanized. Under these circumstances the contribution of foreign capital and enterprise is not so much in supplementing domestic savings as in its strategic role and its intangible benefits. In the following sections of this study three fields in which even moderate amounts of foreign capital can be highly advantageous will be discussed.

The Financing of Social Overhead

Government services, public utilities and housing are of strategic importance in the transformation of more backward, rural societies into modern, more urbanized and industrialized economies. Their availability determines the extent to which people can be grouped together in order to provide a more rational and productive division of labor and permit the efficient organization and operation of secondary and tertiary activities. These services typically involve heavy initial investment because of the relatively long life of the capital assets they require, and governments customarily assume at least a part of the responsibility for their financing.

Before discussing the specific problems related to the financing of each of these types of investment, it would be useful to estimate the relative importance of social overhead investment in total capital formation in a growing economy. In Table I figures are given on the distribution of fixed investment in a number of countries during different stages of development and periods of time. The percentages can only be taken as rough orders of magnitude, because of difficulties in the reliability and statistical comparability of estimating methods and the original data (see table notes). However, the differences between countries do not appear to be as great as might have been expected. Dwellings absorbed between 16 and 25 per cent of gross capital formation, except in Argentina and the United States during periods of very rapid population growth. The great divergence

in the percentages for public utilities can be explained by the inclusion of maintenance charges in the Scandinavian countries and the grouping of certain public utility expenditures under government or trade and services in the United States since the end of the last war. Excluding these countries, the range is only between 19 and 27 per cent. Relative differences are considerably greater, however, for investment in government services. The share of total social overhead ranges from about half to two-thirds of total gross capital formation, and there is slight though not very significant evidence that the proportion may be a bit higher for developing than for mature economies (after discounting the percentages for Sweden and Norway for the reason given above). But the main point to be made is that a very substantial part of total investable resources must continually be devoted to the formation of social overhead capital.

Public utilities not only require heavy investment in structures and equipment but they typically operate most efficiently on a relatively large scale. These characteristics pose a special problem in less-developed countries in which the minimum efficient size of new installations is large in comparison with existing capacity. The chief problem in many of the metropolitan centers of Latin America, however, is not that scarce capital is tied up in excess public utility capacity, but that supply has lagged far behind demand for these services. Periodic power shut-offs, delays in the delivery of raw materials or finished goods, and other inconveniences tend to reduce productivity and often lead entrepreneurs to invest in expensive duplicating facilities for their own plants, carry excessively heavy inventories of goods, or incur in other outlays of an unproductive or unnecessary nature. In addition to reducing the efficiency of existing operations, utility shortages discourage investment in the expansion of old or the development of new activities which depend upon these services.

Latin American countries have by and large not yet found workable solutions for the public control of private utilities companies which guarantee rate adjustments in accordance with changes in costs so as to provide for the replacement of equipment and the maintenance of reasonable and stable profits, while at the same time passing on to the consumer part of the benefits

of increased productivity. The negotiation of rate adjustments and other questions have at times become entangled in problems of nationalism and conflicts between the interests of different social and political groups, problems which tend to be more pronounced in societies undergoing profound social and economic transformation.

Partly as a result of this problem, the relative importance of privately-owned public utilities has decreased substantially over the last two decades in a number of countries in the region, either through the nationalization of foreign property (particularly in the case of railroads) or through the expansion of government facilities (electric power and shipping, for example). By 1955, a relatively small number of railways still remained under private control in Latin America, while only about 20 per cent of total investment in electric energy for domestic supply was provided by foreign private companies. In certain utilities, such as telephones and international telegraph facilities, foreign investment still predominates, while of course in others, such as public water supply, foreign ownership has never been particularly important.

Government owned utilities, perhaps even more than private utility companies, have been obliged to charge social rather than economic prices for their services, with the result that revenue at times has not even covered all of current operating expenses. Consequently, funds for the financing of expansion and even of maintenance have been provided out of current fiscal budgets, a method of finance which reduces the economic independence of government enterprises and sometimes leads to indiscriminate subsidization and inefficiency. Furthermore, this does not often prove in practice to be a dependable source of long-run financing because of the competition of many other demands on scarce budgetary resources.

Housing, on the other hand, is not a field in which direct government investment is of very great importance in Latin America, even though private investment has not been sufficient to avoid the appearance of severe shortages in most of the metropolitan centers of the region. These shortages are most prevalent in low and middle income dwellings, while more luxury types have if anything received too large a share of total investable

resources in many countries. Given the distribution of income and inflationary factors, this latter tendency is of course not very surprising. Because of the exceptionally high rate of population increase and urbanization in the region, residential building can be expected to represent a particularly large claim on fixed capital formation. The rate of population growth and its distribution between urban and rural areas in Latin America during the last twenty years is very similar to the experience of the United States at the end of the last century, when housing accounted for 35 per cent of the increase in the capital stock.

Per cent population increase in	Rural	Urban	Total
United States (1880-1900)	27	113	51
Latin America (1935-55)	35	92	55

Sources: U.S.: *Historical Statistics of the U.S. 1789-1945* (Washington, 1949), p. 29.
L.A.: E.C.L.A.

Residential construction is of course not an activity which normally attracts foreign capital, so that almost all of this kind of investment must be financed with domestic savings. Tax exemptions for lower cost dwellings and policies aimed at activating the market for mortgage bonds are two methods for stimulating the desired amount and type of private investment. But it is not likely that huge housing backlogs for most low and some middle income dwellings can be adequately financed without the assistance of governments in the form of public housing or official loans for private construction. In some countries contributions to social security institutions have been made available for mortgage loans to the insured, but a satisfactory solution to this problem may call for greater government budget appropriations for this purpose and the shifting of some private investment away from non-essential construction to more productive activities.

The third category of social overhead capital—government services such as education, highways, street lighting and sanitation works—provides another heavy claim on fiscal resources, and it is also an easy matter to refer to numerous deficiencies in the provision of schools, hospitals and other essential facilities in most Latin American countries. In the case of these services,

moreover, tax revenue is the principal if not the only source of financing. And yet these claims must compete with appropriations for government-owned public utilities, housing, contributions to official credit institutions and development corporations, and other capital outlays, not to mention the increasing need for current expenditures on expanded public administration and social security and the drain of subsidies paid out to public enterprises and consumers.

It is not surprising, then, that the share of government in total capital formation in Latin America has risen from 20 to 30 per cent during the postwar decade. In other less-advanced countries and regions moreover, the share of public investment is frequently much greater. For example, the second Five-Year Plan of India allocates 60 per cent of investment to the public sector, and in Israel the composition of total gross investment was similar in 1955. Approximately the same situation is found in Africa,[11] and even in Puerto Rico the government has been estimated to have financed 44 per cent of total capital formation between 1950 and 1954.[12] Such elevated percentages could be expected to put an extraordinary burden on public finance in any country, and particularly so in less-advanced nations in which tax yields are closely tied to the level of foreign trade and tax administration is often deficient. Thus, in every Latin American republic for which data are available, at least half of public investment has been financed with credit—much of which has been inflationary—at one time or other during the postwar period.[13]

The simultaneous solution of the problems of shortages in social overhead capital on the one hand and the inadequacy of public finance on the other, would appear to call for a rise in the share of social overhead financed by private capital and/or an increase in the amount of non-inflationary resources available for public investment. With regard to private financing of social overhead requirements, it is difficult at present to conceive of how this could be accomplished directly through the greater use of internal savings. Private investment is not appropriate for the

[11] See OEEC, *Investments in Overseas Territories in Africa, South of the Sahara* (Paris, 1951), Chapters VII and VIII.

[12] S. L. Descartes, *Savings and Investments in Puerto Rico* (San Juan, 1956).

[13] For more details, see the special study on government finance in the *Economic Survey of Latin America 1955*, Part II, particularly chapter III.

financing of traditional government services, and in housing, even though there is much room for the more effective mobilization of private savings, as has been observed there probably exists a need for an expansion rather than a contraction of government outlays in this field in most Latin American countries. By charging more realistic prices for government-owned public utility services, the drain on current fiscal budgets can be substantially reduced; but experience indicates that very little can be expected from private domestic sources to help with the expansion of public utility capacity. It would also be difficult to cut back on many contributions to official credit institutions and development corporations without adversely affecting economic development, because these agencies operate precisely in fields where private domestic funds are insufficient.

There also exist severe limitations to increasing substantially the amount of non-inflationary resources available for public investment, at least over the short run. It is neither necessary nor possible to enter here into a discussion of the many possibilities for raising tax revenue. The main point to be made in this regard is that it is unreasonable to suppose that public investment can be financed almost entirely out of current tax revenue; public borrowing has always played an important role in the financing of development expenditures in almost all countries. In Latin America, however, internal markets for the sale of public bonds are almost everywhere virtually non-existent, except in the case of certain isolated issues or obligatory purchases. In general, public bonds are concentrated in the hands of central banks and other public financial and social security institutions which in some cases have been created for the specific purpose of marketing these securities, so that in effect what governments have mainly been doing is borrowing for themselves. The creation of more favorable conditions for the voluntary purchase of government securities on the part of the general public is a necessary but time-consuming task.

Meanwhile, the collaboration of foreign capital can be of crucial value in providing immediate solutions for the dilemma of financing strategic social overhead investments. Some private funds from abroad are available for public utilities, official international loans are also obtainable for specific projects in such

basic development as highways and power, and heavy equipment exporters in the industrial countries have been increasingly inclined to finance sales with medium-term credits. But there is a notorious gap in the present international credit situation, and that is the inability of less-developed countries to place government bonds in the world capital markets. Although official international financial institutions have had some success in discounting the early maturities of their loans with private banks, and some private banking syndicates have made credit available to certain Latin American governments (although sometimes fully backed with collateral in gold or its equivalent), there are no signs at present that markets will again become generally accessible to foreign government bond flotations.[14] Since almost all Latin American countries have arrived at settlements with foreign bondholders on old outstanding debts and have made an excellent record in servicing their postwar obligations, it would appear that the environment is appropriate for steps to be taken to facilitate an orderly restoration of this highly useful and flexible channel for foreign investment.

Foreign Investment and the Balance of Payments

The balance of payments is of great strategic importance in the economic development of countries like those in Latin America which depend rather heavily on foreign trade. For Latin America as a whole, it has been estimated that the import content of investment is about 30 per cent, although this proportion varies considerably from country to country, exceeding 50 per cent in some cases. The remaining percentage does not, however, reflect the relative importance of domestically produced capital goods, because included in this amount are outlays for the internal transportation and installation of imported equipment, which are conventionally considered to represent approximately half the value of the latter. Furthermore, imported and locally produced goods are often needed in combination, so that in the absence of the imported component, total investment might have to be reduced considerably below what it would otherwise be, whereas

[14] During the postwar period certain governments have been able to place bonds in the New York market, but aside from Canada, and a few other more developed countries, this source of financing has been closed.

shortages of domestic components can often be covered by imports without affecting the level or composition of investment.

The process of saving and investment in less-advanced countries is thus somewhat different from what it is in highly industrialized nations. In the latter, the act of saving or withholding from consumption releases resources for the production of capital goods which would otherwise be devoted to the output of consumer goods. In less industrialized countries, the function of saving is largely to release sufficient foreign exchange to cover the importation of capital goods which are not available locally, as well as to release scarce factors which can be used in the production of the latter. If this requires an increase in imports and there is no export surplus to draw upon, then saving must reduce the demand for consumer goods imports or for products which are both consumed locally and exported, or it must release resources which can be devoted to raising production for export.

The almost infinite elasticity of supply of all types of goods afforded through the use of imports might appear to be a very favorable factor in overcoming investment bottlenecks created by the relative immobility of internal factors of production in many less-advanced nations. However, the flexibility which imports impart to capital formation capacity depends upon the elasticity of supply and demand for foreign exchange. To judge from the balance of payments difficulties which afflict many Latin American countries, it would appear that the role of imports in capital formation capacity, far from being a flexible instrument tending to increase the elasticity of supply, may more often be one of the major impediments to the more effective utilization of savings. In a number of republics the chief source of balance of payments difficulties is domestic inflation, and the indicated solutions have to do primarily with domestic monetary and fiscal policies. But as in the case of the financing of social overhead capital, foreign investment can also play a particularly useful role in supplementing capital formation capacity in less-advanced countries.[15]

The contribution of the initial act of foreign investment is

[15] In Argentina economic development has been brought to a virtual standstill by a serious secular decline in the capacity to import. In such cases, the insufficiency of foreign resources may be a formidable obstacle to carrying out a program of reconstruction aimed at creating new opportunities for employ-

easy to appreciate, since the import of capital goods does not reduce the general availability of foreign exchange in the receiving country. On the contrary, since foreign companies must cover local as well as import costs of the investment and provide the initial working capital, they customarily need to convert a certain amount of foreign exchange to local currency. Thus, not only does the host country benefit directly from the provision of imported capital goods, but the general availability of foreign exchange is increased.

The effect of foreign-financed activities on the balance of payments of host countries during their operational phase is a more complex matter. Concern has been expressed over the fact that most of additional expansion is usually financed out of profits, so that imports of fresh capital are likely to be quite small in comparison with remittances abroad of interest and dividends, which thus have to be covered mainly from the host country's general availability of foreign exchange. Furthermore, if the activity financed is a success, accumulated dividends can be expected to exceed greatly the total amount invested during the life of the capital assets.[16] But the net flow of foreign capital and profits remittances is only one aspect of the impact of the operation of foreign enterprises on the balance of payments. They affect the supply and demand of foreign exchange in a number of other ways, both directly and indirectly.

Aside from the movement of capital and dividends, measurement of the direct effect must take into account foreign exchange earned through exports and expenditures on imported equipment and materials. The results of a sample survey conducted in 1955 covering about four-fifths of United States-con-

ing the factors of production displaced from depressed activities, financing the re-equipment of basic industries and services which have been allowed to become depleted, and correcting the distortions which have led to the decline of export activities.

[16] This last comment is of course not applicable to international loans, the repayment of which exceeds the original investment only by the amount of the interest charged while they are outstanding. For this reason it has been felt in some circles that loans are more convenient for balance of payments reasons than equity capital. As shall be seen in the text, however, a series of other factors must be taken into account in judging the effect of foreign investment on exchange availabilities. As far as economic considerations are concerned, the suitability of portfolio or equity capital depends mainly on the nature of the activity in which it is to be invested and the availability of alternative sources of funds.

TABLE II

Foreign Exchange Payments and Receipts of U.S.-Controlled Companies in Latin America, 1955

(Millions of dollars)

	Agriculture	Mining & Smelting	Petroleum	Manufacturing	Public utilities	Total
A. *Foreign exchange receipts*						
Capital movement	13	—7	20	61	43	129
Exports in dollars	329	609	1,127	39	2	2,106
Exports in other currencies.	13	47	—	45	—	105
Total	355	650	1,147	145	45	2,340
B. *Foreign exchange payments*						
Remittance of Profits and interest	40	93	424	53	38	650
Imports from the U.S.	38	76	164[a]	237	30	546
Imports from other countries	12	1	94[a]	45	—	152
Total	90	170	682	335	69	1,347
C. *Net movement of foreign exchange* (A-B)[b]	265	480	465	—190	—24	993

Source: United States Department of Commerce, *Survey of Current Business*, January 1957.

[a] Excludes $190 millions of oil products imported by U.S. distributing and marketing companies in Latin America from U.S. companies producing petroleum in Latin America.

[b] A minus sign means a net outflow of foreign exchange (excess of payments over receipts).

trolled companies in Latin America may serve to illustrate the relative importance of these different factors (see Table II). In this year, remittances of profits and interest by these companies exceeded receipts of new capital by $520 millions, but exports surpassed imports by almost three times as much, so that the net direct effect of foreign operations on the balance of payments was favorable by about one billion dollars.

It can be seen from Table II that the direct balance of payments effect tends to be very favorable for export activities and unfavorable for activities producing mainly for domestic consumption. The reason for this is of course that exporting firms do not earn enough local currency from domestic sales to cover their local currency obligations. On the other hand, most of the sales of manufacturing and public utility firms is for local currency, so that they are obliged to buy foreign exchange to meet their foreign currency commitments.

Since the balance of payments effect of the operation of foreign enterprises depends to a large extent on the amount of their local currency obligations, it is interesting to observe the composition and distribution by activities of these local payments (see Table III). It will be noted that the total difference between local income and payments in Table III ($1,019 millions) is approximately the same as the total difference between foreign exchange payments and receipts in Table II ($993 millions).[17]

Expenditures in local currency of the United States-controlled companies covered by the survey in 1955 amounted to $4.3 billions—$1.8 billions for materials and equipment, $1.1 billions in taxes, $1.0 billions in salaries, and another $370 millions in other and unspecified. Salaries are of course fixed by collective bargaining agreements between foreign firms and workers organizations, and taxes are usually set in agreements between foreign companies and governments in the case of those firms producing mainly for export, and by the level of taxation on comparable local industries in activities the output of which is

[17] This comparison by activities in Tables II and III reveals certain discrepancies, which are particularly great in the case of public utilities (local payments apparently exceeded sales by $45 millions, but there was a net outflow of foreign exchange equal to $24 millions). It should be recognized, however, that companies also rely on secondary sources of funds which are not included in this comparison, such as the liquidation of inventories, local credit and changes in other local assets.

Table III

Local Payment and Sales by United States-Controlled Companies in Latin America by Activities, 1955

	Materials & equipment	Local payments: Taxes	Local payments: Salaries[a]	Other & unspecified[b]	Total local payment	Income from local sales	Difference between local income and payments
	(Per cent of total)				(Millions of dollars)		
Agriculture	39	13	39	9	374	85	— 289
Mining and smelting	28	43	24	10	563	108	— 455
Petroleum	36	39	18	7	1,426	963	— 463
Manufacturing	59	12	19	10	1,086	1,319	233
Public utilities	25	10	45	20	305	260	— 45
Trade	65	9	16	8	406	—	—
Other industries	34	8	31	27	139	—	—
Total (millions of $)	1,816	1,063	987	367	4,298 (3,754)[c]	— (2,735)[c]	— (—1,019)[c]

Source: United States Department of Commerce, *Survey of Current Business*, January 1957.

[a] Including payments to foreign personnel.

[b] Including interest, royalties and dividends amounting to $65 millions for Latin America as a whole, 30 million of which corresponded to the petroleum industry.

[c] Totals excluding trade and other industries, for which information is not available on income from local sales.

consumed internally. To the extent that wage and tax rates are determined by existing levels in competing enterprises, such payments by foreign companies are limited by factors beyond the direct control of the host country.

Expenditures for locally produced materials and equipment, however, are determined mainly by the availability of supplies comparable in quality and cost with imported merchandise. These payments are the most important of those made by foreign firms, and there is no particular limit to their future expansion beyond the ability of host countries to produce efficiently greater quantities of the goods which these companies consume. Although the margin for further substitution by local output may be quite narrow in some industries in the more industrialized republics, there still exist many opportunities to do so in most of the countries of the region. In a number of them, however, the implicit taxation of foreign enterprises through the use of penalty exchange rates, obliging them to sell foreign exchange at rates higher than those generally prevailing, is a positive discouragement to local purchases, because domestic goods are made more expensive in this way.[18]

Purchases of domestic materials and equipment are relatively more important in the more economically developed republics, particularly in Argentina, Brazil and Mexico. It is precisely to these countries, of course, that foreign capital is mainly attracted for investment in manufacturing, which normally relies to a greater extent on local supplies. Thus, the level of economic development itself, through its effect on the availability of local goods consumed by foreign companies, on the purchasing power of domestic markets, and on the level of salaries, is an important factor in determining the direct contribution of these enterprises to the balance of payments and diversified economic growth.

Although the direct balance of payments effect of the operations of foreign companies is determined by the relation of local

[18] This is not to deny that indirect methods of taxation have certain advantages, in that they are more difficult to evade than direct taxes and they are often not limited by tax agreements between governments and foreign enterprises. However, it is at the same time necessary to realize that this gain may be at least partially offset by a reduction in local purchases, and that indirect taxation may impose a heavier burden on foreign firms than direct taxes, because the latter can often be used to offset part of the income taxes paid on dividends in the home country.

payments to local sales, and it is beneficial for host countries to try to maximize these payments so long as they do not affect production or new investment adversely, it does not follow of course that it is desirable for local sales to be as small as possible in order to oblige the companies to sell the maximum amount of foreign exchange. Local sales, which accounted for about half of total sales of United States companies in Latin America in 1955, result in a saving of foreign exchange through the substitution of imports. The manufactured articles produced by foreign firms are often precisely those for which the income elasticity of demand is greatest in rapidly growing countries and which would otherwise probably have to be imported in increasing amounts. Although the share of primary goods output sold in local markets by foreign companies is less, sometimes these products are sold at prices below those prevailing in world markets or serve as the basis for domestic secondary industries, such as refining and smelting. Thus, the indirect benefits to be derived from local sales may be just as important as any direct contribution to foreign exchange availabilities.

It is very difficult to measure these benefits in quantitative terms, however. The total value of local sales is not, of course, an accurate indication of foreign exchange savings, as is the net movement of exports, imports and financial transactions for exchange earnings. In addition to these factors, it is also necessary to take into account the import content of goods and services inputs purchased locally, for these are of great relative importance in transformation and distribution activities, which sell most in local markets. It could also be argued that the amount of foreign exchange saved by producing any article locally should be calculated on the basis of the price which would have to be paid if it continued to be imported, not the price of the substitute, which might be considerably different for a number of reasons.

The indirect foreign exchange benefit from investment in such service activities as public utilities may be just as tangible although more difficult to measure. They do not produce exports nor can they be said to substitute any imports directly. However, they do provide services which are essential to other activities which provide exports or substitute imports, or they help to

release domestic resources which can be used to increase the output of these activities. Therefore, investment which produce important "external economies" either by eliminating bottlenecks or in other ways which raise the productive efficiency and enhance the fuller utilization of installed capacity in the economy as a whole, may contribute just as much to stable growth and balance of payments equilibrium as investment in activities which have a more apparent beneficial effect on foreign exchange availabilities.

In summary, then, the role of foreign investment can be of strategic importance in providing capital goods in the initial act of investment and contributing to foreign exchange earnings and savings during the operational phase, but it may also provide external economies which increase productive efficiency, help to assure the fuller utilization of available capacity and resources, and enhance the opportunities for domestic investment and the development of new industries. The net contribution of foreign enterprise will be greater the more closely it is integrated into the economy of the host country. In the final analysis, the degree of integration will depend in great measure upon the level and diversity of economic development in these countries and the complementarity of domestic investment. In this respect, foreign enterprise can be of additional help in supplying what might be called intangible capital in the form of the technical knowledge and skills which must increasingly be put to use in developing countries in order to assure the diversity and complementarity of economic growth. This is the subject of the final section.

The Transfer of Improved Techniques and Skills

Modern economic development depends just as much on the capacity of an economy to absorb new modes of production as on the capacity to save and invest.[19] Experience in some advanced countries indicates that increases in productivity over the longer run have been due mainly to the more efficient employment of all factors of production rather than to net additions of capital. This is not to say that technology and capital are substitutable, since usually one is accompanied by the other; but the introduc-

[19] The author is indebted to David L. Pollock of E.C.L.A. who carried out a large part of the research on which this section is based.

tion of many more efficient production methods requires a relatively small amount of fixed investment.

Much of the increase in agricultural productivity which has taken place in the world, for example, is attributable to such factors as the more rational organization of work, crop rotation, scientific cattle breeding, and the use of improved seeds and fertilizers, which entail very moderate fixed capital outlays. In order to increase agricultural productivity sufficiently in the United States to reduce agricultural employment from 64 to 18 per cent of the active population, it was necessary to devote only 3 per cent of total fixed investment to agricultural equipment between 1850 and 1948.[20] Similarly, improvements in the organization of work and the fuller utilization of modern know-how could raise productivity appreciably in Latin American industry with little or no new investment, as was demonstrated in a field study of the textile industry carried out by ECLA in 1951.[21]

Considering its effects, the creation and transmission of knowledge is a most important economic activity taken by itself. Moreover, knowledge has the unique characteristic of being available for international dissemination without reducing the supply available in the country of origin while adding to the stock of the recipient. Yet, wide disparities exist in the levels of technical knowledge held by the underdeveloped as compared to the industrialized countries. Many reasons account for this geographic confinement. Among them are the growing integration of various branches of technology, their reliance upon advances in basic research, their growing interdependence with other disciplines, and the high cost of research. Scarcities of trained manpower have been another limiting factor in the underdeveloped countries, aggravated moreover by the growing need for teamwork

[20] R. Goldsmith, "The Growth of Reproducible Wealth in the United States from 1805 to 1950," *Income and Wealth of the United States, Trends and Structure*, p. 306. The figure cited in the text refers to the share of the net increase in the fixed capital stock. To the extent that the life of agricultural equipment is less than that of the average of the total capital stock, its share in gross investment has been somewhat larger because of greater replacement requirements. Investment other than in agricultural equipment, such as in land reclamation and irrigation, may of course absorb a rather large amount of capital in some Latin American countries.

[21] *Labor Productivity of the Cotton Textile Industry in Five Latin American Countries*, United Nations, 1951.

in research and by the large organizational framework which increasingly is superseding the role played by the individual innovator in past decades.

The geographical confinement of technical innovation creates special problems of assimilation in less-advanced countries. In the first place, the techniques developed and incorporated into productive equipment and processes are sometimes not particularly appropriate in different conditions of market size and relative factor endowments. Even as certain imported production goods or techniques might not reach their optimum usefulness in an underdeveloped country, it also occurs that the advantages that might be derived from a foreign enterprise located in such a country are partly lost to the rest of the economy because the enterprise is technically too advanced with respect to its environment or because the techniques employed are based precisely on the underdeveloped state of affairs in the host country, with its abundant cheap labor, untapped resources and low taxes. In so far as this is true, the main vehicle for transferring productivity gains from these activities to the rest of the economy is through income payments mainly in the form of salaries, taxes, and local purchases of materials and equipment, as was seen in the last section.

Nonetheless, many channels do presently exist through which new and useful forms of knowledge can be transmitted. In the ensuing portions of this section, attention will be given to the commercial channels of transmission, which in practice are of the greatest importance and which are more directly related to the activities of foreign investment and enterprise. Commercial transfers can take place either by means of the establishment of a new foreign enterprise or through the purchase or rental of patents and managerial or technical services.

First, the characteristics and forms of transmission of technical knowledge by means of direct foreign investment will be considered. At the outset, the parent company's full range of knowledge will be brought to bear upon such basic considerations as estimating available raw material and intermediate resource requirements; carrying out market surveys to estimate potential demand for the final product; determining the financial and manpower needs to create and staff the plant for given levels of

output; and perhaps aiding local businessmen to set up production of the type of supplies which the new enterprise finds it more economical to purchase locally than to import.

Many foreign enterprises pioneer in the production of new articles or in new ways of processing goods, thus utilizing their accumulated experience and research to the benefit of foreign countries. Grace and Company, which perfected the first commercially successful papermaking process from sugar cane bagasse fifteen years ago in Peru, recently developed a new and improved continuous quick-pulping process in collaboration with two other foreign firms, and is planning to establish new paper mills using the process in several other countries including Colombia and Cuba. In this way an abundant natural resource is being converted into a product which not only saves foreign exchange spent on paper imports but also promises to have export possibilities. At the same time, by-products from the production of caustic soda used in paper making—principally chlorine and muriatic acid—have become more abundantly and cheaply available for the use of other local industries in Peru. Another example of foreign innovation is revealed by a survey of 46 foreign-owned firms in Mexico in 1956,[22] which showed that half of them had created special products for sale in the local market, products which are not manufactured in any other country.

A considerable amount of specific technical knowledge, as well as general industrial discipline, is imparted to the economy of the host country through on-the-job experience gained by local employees in foreign firms. Many Latin American republics have legislation requiring that a stated percentage of the labor force in each enterprise be reserved for their nationals, but the growth of the local staff component during the postwar decade has been so pronounced that it now represents a level far in excess of the minimum requirements specified by such legislation. This upward trend has undoubtedly resulted both from deliberate policies of most foreign enterprises and from improved educational bases evident within the Latin American countries themselves. According to the survey already cited on the operations of United States companies in Latin America, 98.5 per cent of

[22] Asociación Nacional de Importadores y Exportadores de la Républica Mexicana, *Comercio Internacional*, June-July 1956.

total employees and 82.6 per cent of supervisory, professional and technical personnel of these companies were recruited locally.

In addition to on-the-job training, many foreign firms conduct special training programs. For example, a petroleum company reported[23] that during 1956 approximately 3,800 workers took special job and trades training courses conducted by the firm, and supervisory training courses were attended by 1,350 employees. In addition, in this year 181 scholarships financed by the company were in effect, 148 for study in local schools and 33 for study abroad, a program which is greatly in excess of legal and contractual obligations. In the study already cited of 46 foreign companies in Mexico, it was found that 26 provided special training for local employees, 21 contributed to the support of Mexican universities and technical institutes, and 13 continually sent local personnel abroad for special training. A rubber manufacturer reported that in fact six of his local technicians had been commissioned to conduct training courses in other Latin American countries.

This raises the question of to what extent the technical knowledge and methods introduced by foreign firms are of benefit to the rest of the economy of host countries outside of the specific operations of innovating firms themselves. Because of the frequently high level of wages and working conditions in these firms, the rate of labor turnover and thus the dissemination of the skills learned is not likely to be spontaneously very rapid. With regard to production and organizational techniques, most foreign firms are not likely to part with them if this means relinquishing financial control. When the use of patents and industrial rights is granted to other local enterprises, it is usually against royalty payments or by the transfer of stock on the part of those firms who become licensed to utilize such rights.

In this way joint foreign and domestic enterprises can be formed to combine advanced techniques with domestic knowledge of local conditions, a combination which can be extremely useful to both foreign and local businessmen. There are indications that joint enterprises have in fact been gaining in impor-

[23] This and some of the other specific examples cited in the text are taken from a small sample survey conducted by E.C.L.A.

tance in Latin America in recent years,[24] and this is perhaps the only really effective way of sharing entrepreneurial skills through the operation of direct investment. Apparently, however, most investing firms are not interested in establishing affiliates abroad which they would eventually cease to control. This is illustrated by the following statement of a large mining company: "Our experience with joint enterprises with local private interests has been generally satisfactory, where direction and control of the operation has remained with this company. It has been our experience, however, that joint enterprises, domestic or foreign, where the responsibility for management is not centered in one entity have in many cases been unsuccessful."[25]

Because of some of these inherent problems in the transfer of technical knowledge to domestic enterprises by means of direct foreign investment, increasing interest has been shown in methods which do not entail equity control of the techniques made available. Although these forms of transmission may not be as important quantitatively as transfers via foreign direct investment activities, they have an important bearing on a vital issue for Latin America, namely, how to facilitate the rapid introduction of modern technology while at the same time fortifying the local entrepreneur in developing countries. As these local entrepreneurs gain in experience and financial strength, the relative importance of these forms of transfer disassociated from foreign equity control are also likely to increase.

In essence, all such arrangements entail four basic elements. First of all, they represent a means of directly transferring highly specialized technical knowledge of a proprietary nature from an enterprise in one country to an enterprise in another under terms specifically listed by legal contract. Secondly, the investor often provides little or no capital and equipment, and holds less than a majority equity interest in the voting stock of the recipient enterprise. Thirdly, payment is agreed upon by some preset formula, such as an outright cash or stock receipt, or

[24] See, for example, United States Department of Commerce, *Foreign Investments of the United States*, Census of 1950, p. 23. But in 1950 "foreign investments in marketable securities" of United States controlled firms still amounted to less than 7 per cent of the total equity value of these firms in Latin America. (See appendix Table 10 in this source.)

[25] See footnote 23.

a combination of both. And finally, the agreement is usually contracted for a stated time-period, although the period is often extended when and as mutually desired. A wide variety of these contractual arrangements exists, but basically they stem from two main types—licensing agreements and specialized management or consultant contracts.

Although data are not available which would permit a comprehensive picture of the variety and application of these contracts within Latin America, some illustrations can be given to indicate their diversity of form and industrial application. One United States Company, specialized in the manufacture of household appliances, has long placed a great deal of emphasis on carrying out its foreign operations through licensing agreements rather than in the form of direct investments. A special staff of engineers and other technicians is maintained in the United States to gather and disseminate the technical information required by the foreign licensees; screen, file and take out patents in all countries deemed relevant; maintain special facilities for training licensee personnel in the United States or send its own personnel abroad; and advise on engineering and plant-layout methods. These services are all provided at a fraction of the total cost of the company's annual expenditures for research and development. Moreover, some licensees maintain representatives on a more or less permanent basis in the United States plant so as to ensure a constant transmission of information back to their own factories.

Of the numerous operations of this firm in Latin America, mention can be made of an elevator factory in Brazil which expanded from a small beginning under a license granted by this company to its present status as the world's third largest elevator manufacturer. The extent to which these arrangements tend to spread regionally can also be seen from the fact that a company was set up in one Latin American republic during 1955 to manufacture refrigerator component parts under a license with a company in another Latin American republic which in turn was a licensee of the United States firm.

In the realm of management and consultant contracts, one well-known company offers a comprehensive series of technical construction and advisory services encompassing economic, en-

gineering and market surveys prior to plant construction; plant design and blueprinting; plant construction; and plant operation, management and marketing in a broad field of industrial activities. Within Latin America, this company has designed and built plants or handled construction activities in Argentina, Brazil, Chile, Mexico, Colombia and Guatemala, under various contractual arrangements, and encompassing chemicals, plastics, steel plants, wood-processing plants, among others. In the case of the Compania de Acero del Pacífico for example, organized in 1945 as a Chilean stock company, this firm was retained initially under a management-advisory agreement to design and supervise building operations for the company's installations. Subsequently the contract was expanded to provide information and assistance on specific problems arising out of the company's current technical operations, and to continually make available, as relevant, its own highly specialized engineering and managerial skills so as to keep modern methods and processes readily available to the Company's management, by its own staff or through training programs.

Many other illustrations could be given of the transfer of technical knowledge without equity control in other fields of activity. In the public-utilities field, construction-consultant contracts have been reported for extensive national road-building programs whereby, after actual construction had been completed, the foreign contractor turned over road-maintenance installations, manned by trained local staff. Other public-utility illustrations refer to port and dock facilities, some power-generating installations and many others. And finally, large United States hotel-chains have been contracted to operate wholly Latin American-owned groups of hotels, at times providing blueprints which incorporate modern structural and engineering advances and include accommodations specifically designed to meet the tastes of the United States tourist trade.

Both types of commercial transmission of technical knowledge —one accompanied and the other unaccompanied by foreign equity control—have their particular advantages and applications in less-advanced countries. The advantages of transfer by means of direct investment are obviously greatest in large-scale activities employing highly complex production and marketing techniques.

The experience of local entrepreneurs is likely to be less in this type of activity; and with regard to some export industries, small, independent producers would not have access to the integrated marketing and distribution facilities of large international corporations which are almost essential for their successful operation. For example, the Royal Commission on Canada's Economic Prospects stated in a recent report:

> . . . what Canada has required, especially in the course of her recent economic development, is a 'package' of substantial capital, technology, skills and markets. It is this kind of capital package which non-residents have helped to provide, thereby performing vital tasks which Canadians alone could do either less efficiently or not at all.[26]

With regard to the transfer of technology without foreign equity control, the major advantages are the following. Local entrepreneurship is drawn out to participate actively and directly in the application of modern productive techniques. Where foreign capital is not as critical to successful operation of a given enterprise as is foreign knowledge, the latter can be purchased from abroad at an advanced stage of technological proficiency and at costs far below those required to develop such knowledge domestically. In addition to the direct knowledge so obtained at a price, additional benefits are derived without charge, such as on-the-job experience with the foreign specialists and through subsequent imitation. And finally, from the balance of payments point of view, to the extent that domestic capital is adequate to meet the financial investment requirements of the company concerned, the foreign exchange required for royalty or fee transfers should be less than that involved in servicing foreign direct investments of comparable magnitudes.

Conclusions

The principal conclusions which may be drawn from the foregoing discussion of foreign investment and economic growth in Latin America are as follows:

1. Social overhead capital—government services, public utili-

[26] *Preliminary Report*, Royal Commission on Canada's Economic Prospects, Ottawa, December 1956, pp. 86-87.

ties and housing—normally absorbs a considerable share of total capital formation in a growing economy. Although governments in less-developed countries are often obliged to assume the responsibility for the financing of a rather large part of social overhead, their access to funds is usually more limited than is the case with governments of advanced countries: the tax base is relatively narrow, local bond markets are small or virtually nonexistent, and international securities markets are inaccessible. To a considerable extent these problems can be solved by domestic reforms. At the same time, foreign capital can be of great assistance in seeking more immediate solutions and in relieving the pressure on governments to resort to inflationary financing. Foreign capital will no doubt continue to be made available through the continuation and extension of loans from other governments and international financial institutions. In addition, the reactivation of the international securities market for government bonds of underdeveloped countries would provide a highly useful and flexible channel of investment for which there is no satisfactory substitute.

2. Foreign investment affects the balance of payments of receiving countries both directly and indirectly. According to a study of United States investment in Latin America in 1955, direct foreign exchange earnings and capital imports of United States-controlled companies exceeded remittances of profits and other payments by about one billion dollars. The indirect benefits are more difficult to quantify but include local sales of foreign enterprises ($2.7 billions by United States companies in Latin America in 1955), which presumably substitute in large part for imports and thus save foreign exchange, and the "external economies" derived from investment in such key activities as public utilities. Both the direct and indirect benefits of foreign investment are likely to be larger the more closely foreign enterprises are integrated into the economies of host countries and the more developed are the latter.

3. The most important intangible benefit of foreign enterprise and investment is undoubtedly the transfer of improved techniques and skills. Such transfer can take place via direct investment, with foreign-controlled companies setting up modern plants, introducing new products, training local personnel, and

stimulating emulation on the part of domestic enterprises. If local entrepreneurs and capital are available, however, there also exist ways of obtaining technical knowledge without foreign equity control. There are two basic methods for this type of transfer, licensing agreements and specialized management or consultant contracts. Where foreign capital and know-how are not required in a single "package," transfer without equity control or mixed partnerships have the advantage of drawing out local entrepreneurship to participate directly in the application of modern productive techniques. Experience in Latin America indicates that such arrangements can be effective on a wide scale and can make an important contribution to economic development.

DEVELOPMENT AND DEPENDENCE IN EMERGENT AFRICA

Barbara Ward Jackson

If the central paradox of the modern drive for economic development lies in the gap between the emergent nations' intense desire for modernisation and their relative lack of means of achieving it, it is nowhere more apparent than in the African lands lying south of the Sahara.

If one excludes from this survey the Union of South Africa with its white population of over 2.5 million, the area is overwhelmingly and completely African—and South Africa need not be included in a survey of "emergent" Africa since it can hardly now be considered underdeveloped in any economic sense. The 60,000 Europeans in Kenya, the 70,000 in the Belgian Congo are minute islands in the black sea. In Southern Rhodesia—without about 150,000 white citizens—the African element is over 90 per cent of the population; in Northern Rhodesia it is 98 per cent. Nowhere, between the Sahara and the Union, can one speak of the peoples' aspirations without meaning, almost exclusively, African aspirations.

There is no doubt about what emergent Africa wants—or rather, what the leaders want for the people they more or less represent. They have come to political consciousness at a time when an economic plan is as indispensable to a government as an army or an air force. To increase wealth, exploit resources, raise living standards, and industrialize—this is simply how a modern government conducts its economic policy and how it demonstrates its grip on contemporary techniques.

In fact, this aim of being modern has probably more psychological appeal in Africa than the actual effects of building a more abundant economy. In many parts of the continent, pressure of population is only a problem for the future—one thinks of the Belgian Congo where 12 million Africans live in an area almost the size of the Indian sub-continent. There are no furies of hunger and despair forever harrying a government that fails to increase production. But other forces keep the desire for modernization powerful and active—the sense that Africa has been a pawn

in other nations' games of power and exploitation, the belief that, of all the continents, it has come latest to the feast of life. When a year ago, Mr. K. Gbedemah, the Finance Minister of Ghana, denounced the atomic arms race, he did so on the significant ground that there was a special injustice to Africa in risking the destruction of a world in which, so far, Africans had enjoyed so meagre a share.

Yet the strength of the desire bears no relation to the present inadequacy of the means. There is no continent where economic advance depends more absolutely upon outside sources and where the main levers of modernization lie, in the immediate future at least, more exclusively in other peoples' hands. If one takes five essential elements in any program of economic transformation—export income, agricultural productivity, investment in "infrastructure" (transportation, power, housing), industrial growth and the provision of trained manpower—all African communities lack some of these sources and opportunities on an indigenous basis; some African communities lack virtually all.

Export incomes are of overwhelming importance in most parts of Africa. In fact, only in the Union has manufacturing industry become the largest contributor to national income. Elsewhere, the export of primary products is the basis of prosperity. In the Rhodesias, for instance, before the end of the metals boom, copper provided 65 per cent of all income tax and nearly a quarter of all government revenue. Similarly in the Congo, earnings from exports of copper, zinc, diamonds and uranium, and of agricultural products such as palm oil, cotton and coffee, probably account for nearly 40 per cent of national income in the market sector of the economy. Admittedly, the calculation is not precise. In each economy, the share of subsistence agriculture in the national income can only be roughly estimated, but wherever development is occurring and modern sectors are appearing, the change is anchored in export income, largely of primary products.

For the African, this situation creates a double dependence. Externally, his hopes of advance are linked to the most vulnerable sector of the world economy. Since 1957, the fall in primary prices for virtually all commodities save cocoa has sharply reduced the sums available for local investment. Development

plans are being pruned or extended over longer periods. The large hydroelectric and aluminum projects, for instance, are being either stretched out or deferred.

The internal factor of dependence is the extent to which the export sector is organized by non-Africans. In the case of metals, European or American ownership is virtually total, although some enlightened companies have plans to encourage African share-holding. This is not to suggest that the African has gained nothing from the immense sums earned by mineral exports in the last decade. In so far as he shares in the general development of, say, the Central African Federation of Northern and Southern Rhodesia and Nyasaland, he is drawing his increased wages and opportunities for education to an overwhelming degree from the mining industry. Between 1953 and 1957, his general wage level has increased from £145 to £204 a year and African miners, thanks in part to the efforts of the Rhodesian Selection Trust to relax the industrial colour bar, have advanced their wages in some categories from £171 to £448 a year. In the Congo, where industrial opportunities for the African worker are greater, it is estimated that between 50 and 60 per cent of the national income is now spent by African consumers. Yet this increased prosperity is bringing only a very longterm hope of moving into more responsible positions in the management of the export industries. In Southern Rhodesia, for instance, out of a million potential African school children, only some 700 reach secondary level and only about 55 obtain the final certificate.

The agricultural picture is more diverse. In West Africa, in general, contact and familiarity with Western commercial methods started earlier and indigenous African society was in any case further evolved than East or Central Africa from static agricultural and tribal conditions. In such countries as Ghana or Nigeria the production of the great export crops—cocoa, coffee, groundnuts, palm oil—is largely in the hands of African peasant farmers or cooperative societies. Moreover, Africans help to manage the elaborate marketing structure through which these commodities are put on to the world market. In the other African territories considered here, the African producer does not enjoy this commanding position, save in Uganda where Africans produce the cotton crop, which provides nearly 90 per cent of the

country's export income. Until fairly recently, however, virtually all the processing and marketing of cotton was in Asian or European hands. In the other territories, Europeans—farmers, plantation managers, export firms—are responsible for both producing and marketing the bulk of the exports.

This situation is changing in some measure. The days when East African planters excluded Africans from the production of export crops are over. For some time now, coffee has been grown with great success in Tanganyika by such bodies as the Chaggas' Co-operative and coffee is one of the crops upon which Kenya is now relying to raise the income of its African farmers. In Southern Rhodesia, under the post-war Native Husbandry Acts, an effort is being made to produce technically competent African farmers working with modern techniques on consolidated holdings. In the Congo something of the same purpose is being pursued in the system of *paysannats indigènes*. But this growing attention to Africans as efficient agricultural producers illustrates another facet of their dependence—their basic need for outside help in achieving a genuine increase in agricultural productivity.

According to traditional methods of African agriculture, the tribal leaders give individual families the use of part of the tribe's communal land and on it they practise shifting cultivation with a long period of fallowing. This is a method which conserves Africa's fragile, friable soil and where land is available—as in the Congo—the Europeans have not improved on its principle. But the system breaks down as soon as land is all taken up and the fallowing periods are cut to accommodate more families. And, in spite of much traditional wisdom in the matter of cover for plants and conservation of moisture, African agriculture knows nothing of improved methods and scientific innovations for crops such as coffee, cocoa and cotton which were introduced or reintroduced from outside. African agriculture must therefore turn to expert non-African advice to conserve productivity in heavily occupied lands or to increase it in important export sectors.

The former problem is the more urgent in such heavily occupied areas as Kenya, the lake provinces of Uganda, Ruanda-Urundi or the Eastern region of Nigeria. The latter point is vital where, as in Ghana, the export crop could be undermined by disease or wherever heavy cropping in response to good prices

is endangering the soil. And both tendencies can be found throughout Africa south of the Sahara.

It may well be that this question of increased agricultural productivity is the decisive factor in the Africans's hopes of advancement. Professor Arthur Lewis, in his indispensable report on industrialisation in Ghana, recommends that expenditure upon agricultural education and extension services should be quintupled as the soundest prelude to developing an industrial sector. Only a marked increase in productivity on the farms will release manpower to the cities and provide local purchasing power among the farmers to absorb the manufactures that are to be produced. Professor Lewis is doubtful whether any real advance in productivity has occurred on Ghana's farms. Cocoa has been planted more extensively, but not more efficiently. Meanwhile the limits of further expansion are in sight and the problems of keeping present cocoa farms healthy have not been solved.

Yet, in Ghana as elsewhere, the change from traditional extensive farming to scientific intensive methods involves a vast effort of technical education and capital investment. Results can be achieved without doubt. There are African farmers in Southern Rhodesia today who, after seven or eight years' training and subsidy, are producing as many bushels of maize to the acre as the best European farms. But the program entails steady outside assistance. In Ghana today, for instance, perhaps six students are graduating each year in agriculture and it is an open question how many will be active farmers or extension officers. Other territories even lack an agricultural training centre. And the cost is high. Southern Rhodesia has spent about £3 millions on native agriculture in the last five or six years and the sum has not been sufficient to cover more than a segment of the scattered tribal reserves. A general agricultural program for Africa would require formidable external assistance in technical advice and capital expenditure. Yet there is probably no other road to the modernization African leaders propose.

Nor does agriculture end the story of dependence. In the last ten years, vast amounts of capital have in fact been invested in the two other dynamic sectors of the various African economies –in "infrastructure" or basic development and, in the Union, the Congo, Kenya and Southern Rhodesia, in industry as well.

Transport has always been one of the keys to African expansion. In fact, in East Africa, the railway made Kenya, not Kenya the railway. Since 1945, the pattern has not changed. Over 50 per cent of the Congo's current $900 million development program is devoted to transportation. The World Bank has invested in South African, Rhodesian, East African and French West African railways. In fact, most of the $460 millions lent to Africa by the Bank in the last decade have been absorbed by transport development. Port extensions and urban expansion are universal and few areas have as many ambitious hydroelectric schemes in prospect.

Africa contains the world's largest reserves of undeveloped hydroelectric power and everywhere development is on the way. Schemes already in partial operation include the Owen Falls scheme in Uganda with–ultimately–installed capacity of 155 thousand kilowatts, the Marinel installations in the Congo (211,000 kw) and the Edea scheme in the French Cameroons. The Kariba project in the Central African Federation is under construction (1,200,000 kw). So is Edea II. Firm plans exist for Koilou in French Equatorial Africa (800,000 kw) and Konkure in French West Africa (500,000 kw). The Volta scheme in Ghana could produce ultimately 650,000 kw. And the monster of all schemes is under discussion–the Inga Falls scheme in the Congo–which could generate 25,000,000 kw on the great rapids below Leopoldville at a cost now roughly estimated to be at least $1 billion.

Most of the capital needed for these developments has come from outside. There are, of course, exceptions. The Union received at least $2 billions, mainly from Britain, immediately after the war, but recently, when foreign investment has all but ceased, local saving has been enough to maintain the remarkably high annual investment rate of some 20 per cent of national income. The Congo has drawn on about $1.5 billions in the last decade, but half of it was in reality local profits reinvested by Belgian Corporations working in the Congo. Rhodesia is another area of high investment, with over $1 billion from abroad but with a high internal rate of savings among Europeans as well. Apart from these three great mineral earners, Ghana in West Africa has pursued an exceptionally successful marketing policy during

the decade of high prices for cocoa and has set aside, largely from cocoa, savings of the order of $500 millions.

Elsewhere the local outlook for capital is less secure and much of the development has been carried through by drawing on funds provided by the metropolitan powers. Through the Colonial Development and Welfare Fund and the Colonial Development Corporation, Britain has been making about $70 millions a year available to colonial territories in Africa. The largest effort in this field has been made by the French. In the last decade, French governmental investments in West and Equatorial Africa through the *Caisse Centrale* and *Fides* have been not less than $100 millions a year.

Not all of the $10 billions of post-war external investment in Africa has gone to basic development. The figure includes the expansion of mining facilities—in the Union, a whole new system of uranium extraction has been financed since the war—oil drilling, plantation development and a certain amount of investment in the last of the dynamic sectors—manufacturing industry. European settlers in Kenya have set in motion a brisk growth of light industry, often financed by savings brought with them from abroad. Southern Rhodesia shows the same pattern, with some mineral processing added to it. Diversified industrial production is being officially sponsored in the Congo and the big corporations are encouraged to start up new enterprises. A textile and chemical industry have been launched and manufacturing has more than tripled since 1949. The Union has, of course, a full scale self-sustaining industrialized sector.

Otherwise, Africa has little industrial development to show for the boom in export prices over the last decade and the reason is the now familiar one,—the Africans' dependence upon outside skill and capital. Industry has, in fact, developed where a European entrepreneurial class has brought it into being and in this sector at least managerial capacity appears to be the decisive element. West Africa is in general much wealthier than Kenya. Even Uganda has a higher general level of prosperity. But Kenya has a European and also an Asian entrepreneurial group. This contrast does not mean that African managerial talent will not appear. It is already to be found in the complex commercial relationships of West Africa and in the appearance in certain

trades, for instance the timber trade of Nigeria, of Africans with first class executive capacity. The problem is the scarcity of this indigenous talent compared with the scale and speed of development emergent Africa expects.

The clearest index of this gap between need and available resources in trained manpower can best be studied in Africa's illiteracy rates. These were estimated by Unesco in 1957 to be 95 to 99 per cent in French West and Equatorial Africa, 90 to 95 per cent in Togoland, the Cameroons, Tanganyika and Ruanda-Usundi, 85 to 90 per cent in Nigeria, 75 to 80 per cent in Ghana, Kenya and the Rhodesias, 70 to 75 per cent in Uganda, 60 to 65 per cent in the Congo, 55 to 60 per cent in the Union. In the whole area, excluding the Union, there are five Universities and the oldest is just ten years old. Ghana, with a population of over 5 million, has a graduating class of about 400. One of the problems involved in making the new University in the Central African Federation fully inter-racial has been to find a sufficient number of Africans qualified to study there. This situation can be mitigated in time. Thousands of Africans are studying abroad. The impact of post-war educational expansion is not yet fully apparent. But, for the time being, the gap remains between the ambitions of Africa's new young leaders and the realities and limitations they will have to face.

But this is not all. An even more serious question today is whether the gap may not be about to widen. Another way of stating the dependence of African development upon outside support is to underline the four main forces–apart from the work and energy of the Africans themselves–upon which modernization depends. The first is the administrative and educative work of colonial officials. The second is the provision of capital from governmental sources–usually from the metropolitan government. The third is foreign private capital and the enterprise connected with it. The fourth is the local settler class functioning as a wealth creating group. It seems reasonably certain that over the next three decades the impact on Africa of all these forces will change radically.

In the first place, the political tide in Africa South of the Sahara is flowing strongly towards African independence in all territories where there is no local multi-racial pattern. The

British all-African territories will follow in Ghana's wake to independence, probably within the Commonwealth. The French territories may retain their closer link with France as a result of the referenda of 1958 but the future pattern is still far from clear.

The transfer of political power will no doubt be longer delayed in the Congo, but probably not so long as is believed today. The first elections have been held even if only at a municipal level. The tide will run more strongly now. So far, only Portuguese Africa has avoided both rapid economic and rapid political development.

Under the new conditions, how much of the present administrative framework will the Africans wish to retain? How much can they retain? At what point would, say, a more relaxed attitude to executive efficiency begin to affect the tempo of development? Although Ghana is giving a remarkable demonstration of a non-racial approach in its readiness to retain a number of its old British Colonial officials, such reasonable forbearance may not be general. The pressure for Africanization will be strong and the idea of retaining ex-colonial officers at times unacceptable. But what are the alternatives, given the absolute shortage of trained Africans?

The prospects for publicly-provided capital are equally uncertain. The British government has made it clear that once colonial status is at an end, so, too, are grants under the various colonial funds. Moreover, on independence, the states lose the British government's collateral guarantee to World Bank loans—of which over $170 millions have been provided in the last decade to British African colonies. The French may continue their generous subventions and the resources of the Congo are such that a good deal of investment should continue to be self-financing. Both systems aim at a closer long term bond between the European mother country and the African territory and it may be that the growth of the European Common Market will create some quite new forms of multilateral lending and subvention. But it is fully as possible that European uncertainties and rising African nationalism may end not by creating new sources of capital but by weakening those that exist.

These two queries for the future—the stability of administration and the flow of public capital—will in turn influence the

third, the scale of future private investment. It is impossible to believe that Europe's vast trading concerns will not be as active in the future as in the past. They have already weathered so many economic and political uncertainties in Africa that absolute security is the last condition they demand. Equally, established mining interests are not likely to withdraw and there will surely be capital for further mineral development. But private enterprise is bound to test with caution the intentions and policies of newly independent governments in whatever continent they are to be found. Africa is no exception. Nor have the independent governments of Africa yet had time to go as far as their counterparts in Asia in working out what sort of guarantees and encouragements they are prepared to offer to outside entrepreneurs and investors.

Influential advisers such as Professor Lewis have pointed out that Africa needs outside private capital far more urgently than private capital needs Africa and inducements must be offered if manufacturing industry is to be tempted in to set up its installations and risk its physical capital. It is too soon to be dogmatic about the future but one can hazard the guess that the rapid expansion of political independence across the face of Africa may lead to at least a breathing space in private development.

Finally, the last non-African source of executive energy for potential growth—the settled European and Asian population in Kenya, the Rhodesias and the Congo—is also shadowed with uncertainty. The dilemma is easily described. On one extreme are settlers who see the Africans simply as a permanent docile labor force. On the other are the new young African nationalists who, fired by Ghana's example, press for adult suffrage and hence total African power within a spell of time so short that no adequate African cadres of responsible leadership can possibly be developed. In theory, there should be a middle-of-the-road approach which would gear a general advance towards political enfranchisement to a rapid and determined expansion in African education and opportunity and would also entrench legal safeguards and minority rights not only in some ultimate written construction but today and every day in the political habits of thought of all races.

But in practice the events in Kenya and Southern Rhodesia

tend to confirm the risk that the men who represent this approach are likely to lose their influence to more extremist leadership—both African and settler. In the political upheavals that could result from an aggravation of this trend, economic development would be the first casualty.

The possibility that a large measure of political advance in Africa may be accompanied by an actual slackening in the pace of economic growth cannot therefore be dismissed. Yet this reduction in resources would come just at a time when the independent states would need to make new and more strenuous efforts to train their own citizens, vastly expand their educational effort and seek to increase by every means their supply of technically proficient Africans. Their power to command wealth could weaken at the very moment when the need for it would become more urgent than ever before.

This is a risk which the Western Powers should be prepared to face in time. Not all the problems of Africa's dependence upon outside resources can be solved. Africans themselves have to find out their own methods and aims and possibilities. African leadership itself, not external influence, will decide whether workable relations are possible with foreign enterprise or with European and Asian settlers on African soil. But there are some things which Western governments almost certainly can do in the next decades to assist Africa through the coming period of vast political and economic transition. With forethought and determination, they can see to it that two elements at least in the outside assistance needed by Africans are not lacking. They can undertake a program of inter-governmental lending sufficient to ensure that basic development, the search for agricultural productivity and an expansion of education are not all disastrously checked just as independence is achieved. And they can lay their plans to provide trained manpower for administrative and technical posts when African governments find themselves unable to fill the needed appointments entirely from their own resources.

One might hazard the guess that both operations would be more acceptable to local governments—and more able either to absorb or to counter possible Soviet competition—if they were organized on an international basis. But the essential point is to realize in time that the Western Powers, having ploughed up the

old traditional tribal Africa in search of gold and diamonds and wealth of all kinds, are now launching this great, hopeful but unstable continent on a political venture of incalculable magnitude. The experiment deserves more than casual interest, its inescapable weakness and dependence more than half-hearted support. The question today is whether either its scale or its urgency will be realized in time.

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